No. 71-1169

Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

MOBIL OIL CORPORATION,
Petitioner,

v.

CARL F. MATZEN, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Mobil Oil Corporation (Mobil) petitions for a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit entered in this case on December 17, 1971.

OPINIONS BELOW

The opinion of the Court of Appeals (Appendix C, pp. 15-40) is not yet reported. The opinion and orders of the Federal Power Commission (Appendix D, pp. 41-80) are reported at 42 FPC 164-187. The opinion of the

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[1] The names of the Respondents are set forth in Appendix A to this Petition, which also indicates origin of the controversy as a purported class action in a Kansas State Court (Appendix A, pp. 1-10).

Hearing Examiner (Appendix D, pp. 81-108) is reported at 42 FPC 187-198.[2]

JURISDICTION

The Judgment of the Court of Appeals was entered on December 17, 1971 (Appendix B, pp. 11-14), and this petition is filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r (b).

QUESTIONS PRESENTED

1. Whether the Federal Power Commission has regulatory jurisdiction under the Natural Gas Act over the rates for payment for the royalty interest in natural gas sold in interstate commerce for resale.

2. Assuming the Commission has jurisdiction over such rates, whether the Commission erred in holding that royalty owners may be entitled to payments, retroactively and prospectively, based upon rates higher than those effective under Section 4 of the Natural Gas Act for producers whose filed rate schedules cover the royalty interests.

3. Whether the Court of Appeals erred in failing to remand the case to the Commission for further proceedings *if* (a) the record and the Commission opinion are deficient as to evidentiary predicates and findings to support Commission conclusions, and (b) there is inadequate support for Commission conclusions that exercise of jurisdiction is required to effectuate the purposes of the Natural Gas Act.

STATUTES INVOLVED

Sections 1(b), 2(6), 4(a), 4(c), 4(d), 4(e), 5(a) and 19(b) of the Natural Gas Act, 52 Stat. 821 (1938), as

[2] Under separate cover, Mobil is filing the Appendices to this Petition.

amended, 15 U.S.C. §§ 717-717w, are involved and are reproduced at Appendix E, pp. 109-113.

STATEMENT

The questions presented involve exercise by the Federal Power Commission (Commission) of jurisdiction under Section 1(b) of the Natural Gas Act (15 U.S.C § 717(b)) over the rates for royalty interests in natural gas sold in interstate commerce for resale, and implementation of that jurisdiction under Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. §§ 717c and 717d.

After hearings, the Examiner and the Commission affirmed exercise of such jurisdiction for almost eighteen past years, but the Court of Appeals has reversed, holding the Commission is without jurisdiction, and such rates are to be fixed in collateral state or federal court litigation.

Suits in the Federal And State Courts

Since June 7, 1954, the date of the decision in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, the Commission has regulated the entire volume of natural gas sold in interstate commerce for resale to interstate pipelines in or near the fields of production. Under state law, the various interests in the total volume delivered from a given well are classified principally as "working" interests and as "royalty" interests. The working interest owner is a lessee under a lease granting the right to explore, drill for, produce, recover, and sell natural gas underlying lands covered by the lease. The same instrument generally reserves to the lessor, and his successors, "royalty" expressed by a percentage or fraction (*e.g.*, 1/8) of "proceeds" or "value" of the natural gas if, as and when produced and marketed.[3] Commission regulation has

[3] For a more extensive discussion of the nature of the "working" and "royalty" interests, see: Williams & Meyers, *Oil and Gas Law*, §§ 201, 202, 202.1, 202.2, 202.3, 203, 204.9, 301; Summers, *The Law*

applied to the entire stream of natural gas regardless of these classifications of interests under state law.

However, as the Commission implemented rate regulation, numerous suits were filed in State and Federal courts because of claims by royalty interest owners that the royalty interest is not controlled by Commission regulation, and that these owners are entitled to substantially higher unregulated "prices" or "market values" to be determined in the courts. More than 290 such suits are now pending in courts in Kansas, Oklahoma, and Texas. Such suits were the beginning of the present case.

Mobil is a producer engaged in hundreds of regulated sales of natural gas and is lessee under oil and gas leases in the giant Kansas Hugoton Field. With respect to sales in that field, Mobil has been named as defendant in suits brought in the Kansas courts by royalty owners attempting to recover substantial amounts based upon rates or "values" in excess of the effective rates under filings by Mobil after June 7, 1954 pursuant to Section 4 of the Act.[4]

While such suits against Mobil were pending, the Court of Appeals for the Fifth Circuit, in *J. M. Huber Corp.* v. *Denman*, 367 F.2d 104 (1966), held that the Commission had primary jurisdiction over the principal threshold issues raised in such cases, *i.e.*, whether Commission jurisdiction to regulate rates for natural gas sold in interstate commerce for resale includes the rates for the royalty interests in such gas, and whether owners of royalty interests are prohibited from recovery in collateral litigation on the basis of "values" in excess of

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of Oil and Gas, §§ 11 and 21; and Williams, Maxwell & Meyers, *Cases and Materials on the Law of Oil & Gas*, 1956, Introduction, pp. 13-28.

[4] The "effective rate" is the rate the producer is permitted to collect under Section 4. Such "effective rate" may be firm or subject to refund pending Commission decision on "reasonableness" under Section 4.

effective rates fixed under Sections 4 and 5 of the Act after June 7, 1954.

After the Fifth Circuit's decision, parties to that case filed with the Commission a petition for declaratory order seeking determination of the questions of Commission jurisdiction. Subsequently, Mobil, Western Natural Gas Company (Western), and Pan American Petroleum Corporation (now Amoco Production Company) (Amoco) filed complaints seeking determination of the same jurisdictional questions as applied to royalty interest owners then seeking recovery in state and federal courts on the basis of rates in excess of rates effective under filings with the Commission.

By orders of the Commission, all petitions and complaints raising these issues were consolidated for hearing. Pending Commission decision, proceedings in the state and federal courts then were stayed or otherwise held in abeyance.

Proceedings Before the Commission

Mobil filed its Complaint on October 24, 1966 against Carl F. Matzen, *et al.*, (Matzen, *et al.*). Therein, Mobil requested the Commission to exercise its primary jurisdiction over the issues of jurisdiction in controversies between Mobil and Matzen, *et al.*, concerning royalty payments for a number of past years and to be paid in the future. These controversies then included 283 individual suits and one class action with 14 named plaintiffs, all of which had been instituted by Matzen, *et al.* against Mobil in three courts of Kansas.[5] In such actions, Matzen, *et al.*, claim entitlement to royalty payments based upon alleged "market prices" or "market values" in the Kansas Hugoton Field up to 21 cents per Mcf, substantially in excess of rates effective after June 7, 1954 under Mobil's FPC Gas Rate Schedule Nos. 3, 281, and 282.

[5] According to Mobil's records, the "class" on whose behalf the class action was brought includes approximately 600 persons.

Mobil urged the Commission to enter an order, *inter alia*, (1) confirming its jurisdiction over Matzen, *et al.*, and (2) declaring that Matzen *et al.*, are entitled, on and after June 7, 1954, to royalty payments based *exclusively* upon the effective rates by final Commission actions applicable to the three relevant FPC Gas Rate Schedules under which the volume to which each royalty interest pertains is sold. The answer filed by Matzen, *et al.* alleged that the Commission did not have jurisdiction over such payments and could not grant the relief requested.

By order issued April 3, 1967, the Commission consolidated all similar complaints and petitions then pending for formal hearing. Subsequent procedures included the granting of leave to intervene to forty-two parties and a prehearing conference. Parties then were loosely grouped as the "proponents" of Commission jurisdiction (which included Mobil and other regulated producing companies, a number of Eastern Seaboard distribution companies, the Public Utilities Commission of the State of California, and the Federal Power Commission's Staff) and the "opponents" of jurisdiction (which included Matzen, *et al.*, the Land and Royalty Owners of Louisiana, the State of Texas, and intervening royalty owner associations and groups).

Evidence Before the Commission. Formal hearings were held before an Examiner on January 22-25, 1968. Extensive evidence was submitted by numerous parties.

Mobil's evidence included the contracts executed by Mobil and its predecessors under which the interests involved are delivered to two interstate pipelines, Commission certificates issued under Section 7 of the Act authorizing these sales, and all Commission orders which had accepted the contracts as rate schedules under the Act and otherwise controlled the rates since June 7, 1954. Mobil also presented witnesses explaining its method of computing royalty payments on the basis of the rates effective under the Act, of payment on the basis of sus-

pended rates only upon assurance of responsibility by the payee for any subsequent refunds ordered by the Commission, and of later adjustments on the basis of rates ultimately approved by final Commission action.

As to specific interests of Matzen, *et al.*, Mobil submitted evidence as to their claims in the Kansas courts; the nature of each of the interests of Matzen, *et al.*, under leases committed to the performance of the three gas sales contracts in the Kansas Hugoton Field; the clauses of leases providing computation and payment to Matzen, *et al.* if, as, and when natural gas is produced and marketed; and examples of Mobil's Gas Division Order under which the signer certifies his interest in natural gas delivered under the rate schedules on file with the Commission.

Mobil and other "proponents" of jurisdiction also showed that the jurisdictional issue did not involve the *initial* transaction of executing a lease, or various payments *prior* to production and sale of natural gas, such as "bonuses," "cash payments" and "delay rentals." The record ultimately focused upon (1) the presently existent economic interest of Matzen, *et al.*, in natural gas if, as, and when produced, as defined in terms of a fraction, such as one-eighth, of the total volume produced and sold; and (2) the payment and interest pertinent to the proceedings before the Commission, defined as the continuing entitlement to a "cents per mcf" payment for the interest in the natural gas as and when produced and sold to interstate purchasers.

Other evidence showed application of the Act to the royalty interest since 1954 and the application of Commission rate and certificate jurisdiction to the entire eight-eighths volume of natural gas delivered under a jurisdictional sale, consisting of the seven-eighths or similar fraction attributable to the net working interest, and the one-eighth or similar fraction attributable to the

royalty interest. In addition, Mobil's witnesses showed that the full eight-eighths production of natural gas delivered under jurisdictional sales had been so regulated; the mechanics under which it is now so regulated under the Commission's area rate method; and the financial impact if "values" claimed by Matzen, *et al.*, were substituted for the rates effective under the Act.

Other evidence of similar import was presented by other "proponents" of Commission jurisdiction. The record thus contained extensive evidence as to the exact nature of the interests of Matzen, *et al.*, and others involved, facts as to the Commission's exercise of jurisdiction since June 7, 1954, and a formula presented by a Mobil witness from which impact of claims for "values" in excess of the effective rate can be computed for any jurisdictional sale.

The Examiner's Decision. The Examiner's Decision recited the history of the court cases giving rise to the Commission proceedings and precisely defined the interest actually involved (Appendix D, p. 91):

> "The interest we are concerned with here is called royalty and is created by a reservation in an oil and gas lease in which the landowner grants to the lessee certain rights and privileges, such as, to explore, drill and produce oil and gas, and in the same instrument *reserves to himself, free from the expenses of production, a share in the oil and gas produced or the proceeds thereof.*" (Emphasis supplied)

The Examiner then set forth an extensive analysis of the record, contentions of the parties, and pertinent constructions of Section 1(b) of the Act. Therefrom, he found (Appendix D, p. 100):

> "The result of the leases here involved is that the interests of both the lessor and lessee in gas produced and sold accomplishes the transfer of natural gas in a continuous flow to an interstate pipeline company for resale in interstate commerce."

* * * *

> "By the terms of the lease the royalty owner has a continuing interest in production as the payment flows from acquisition by interstate pipelines of gas for resale for ultimate public consumption. The lessee must account to the lessor for his share of the volumes of gas produced and compensate the lessor for his retained fraction of the production."

The Examiner referred to the regulatory "gap" that would be left if Matzen, *et al.*, were correct; to the connection between the claims of Matzen, *et al.*, for higher, unregulated rates and the consumer interest in just and reasonable rates under the Act's standards; and to the expectation that the "unregulated market" price claimed by them is "higher than allowed under regulation by the Commission." (Appendix D, p. 102). He then concluded (Appendix D, p. 103):

> "Considering the volumes of gas that move in interstate commerce and the uncertainty of the price to be paid for the royalty interest, which has a direct and substantial effect on the price paid by the ultimate consumer, the Commission must now exercise its jurisdiction to insure the reasonableness of price for gas to the consumer."

The Examiner's conclusion was that no additional filing requirements were necessary, except that an owner seeking an increase above that received by a producer should apply to the Commission for the higher rate of payment, submitting any supporting "factual information." (Appendix D, pp. 106-107).

The Commission Decision. Exceptions were filed on issues of jurisdiction, controlling rates, and filing requirements. After briefs were filed and oral argument, the Commission issued its decision, denoted Opinion No. 562, on July 23, 1969 (Appendix D, pp. 41-80). The Commission first referred to the history of the *Denman* case and the numerous controversies giving rise to the complaints filed by Mobil, Western, and Amoco, and to the findings

and conclusions of the Examiner (Appendix D, pp. 48-50). The Commission noted various exceptions by "opponents" of its jurisdiction (Appendix D, p. 52):

> "In reply to these arguments the staff, producers, distributors, and the State of California point out that the mineral lease requires that the producer sell the gas as best he can and that in fact the royalty-payment provision of the lease is not operative until the gas is actually sold."

The Commission then found (Appendix D, p. 53):

> "The basic fact here is the effective retention by the royalty holders of a percentage interest in the gas sold in interstate commerce. While that portion of the royalty contract on which the royalty owners focus, which results in payments prior to the production of gas, may well be nonjurisdictional under the decision in *Panhandle Eastern Pipe Line Co.* v. *Public Service Commission of Indiana*, 337 U.S. 498 (1948), the remaining portion of the arrangement, which results in payment to the royalty holder based on the production of natural gas for sale in interstate commerce, seems to us plainly to be jurisdictional."

The Commission went on to note that the distinction it made between a nonjurisdictional payment and a jurisdictional payment to the same person was not "novel," and cited instances where a "nonsignatory non-operator" interest owner holding a percent interest in proceeds from a gas sale "will technically be a natural-gas company" even though the operator of the property makes all filings with the Commission (Appendix D, p. 53). The Commission rejected "Hornbook definitions or local decisions not applicable to the Natural Gas Act," and held (Appendix D, p. 54):

> "We conclude that if he has contracted to retain an economic interest in interstate sales, he has joined the other interest owners in such sales and he has

become a seller of natural gas and therefore a natural gas company."

The Commission then examined the nature of that "economic interest," and further noted that on the two prior "instances where the matter was before us we asserted jurisdiction," and that because producer filings since 1954 cover the interests of all "nonsignatory" parties or those selling on a percentage basis, there had been no reason to assert "special jurisdiction" over royalty interest holders prior to the court decision involving "market value" claims that gave rise to the instant proceedings. The Commission then concluded (Appendix D, p. 56):

> "The jurisdictional royalty interest has in effect been covered by the producer filing since 1954 and we see no reason why it should not continue to be covered by the producer filing."

As to the points raised by producers' exceptions, the Commission stated: "The producers in general believe that the royalty owner should be allowed no more for his percentage of gas than the finally effective rate which the producer has on file." The Commission thereupon denied this exception, declaring that (Appendix D, pp. 58-59):

> ". . . the royalty provisions of oil and gas leases constitute sales of natural gas for resale in interstate commerce subject to all of the provisions of the Natural Gas Act.
>
> "For regulatory purposes such sales are covered by filings of the producer-operators and payment by the producers to the royalty owners should be made as provided by the contractual provisions of each lease, except that in no event should the payment exceed the just and reasonable rates as fixed by the Commission under the Act."

Rehearing, thereafter, was denied by operation of law; seven petitions for review under Section 19(b) were filed; and all such petitions ultimately were transferred to the Court of Appeals for the District of Columbia Circuit.

The Court of Appeals Decision

The Court of Appeals summarized facts as to prior proceedings (including *J. M. Huber Corp.* v. *Denman*, 367 F.2d 104 (5th Cir. 1966)), and genesis of the cases before the Commission. The court then referred to the evidence on "industry practice with respect to oil and gas lease agreements," stating that such evidence was "well summarized" by the Examiner, and to the "basic fact" which the Commission found determinative of the jurisdictional issue, "the effective retention by the royalty holders of a percentage interest in the gas sold in interstate commerce." (Appendix C, p. 21). The court then referred to Section 1(b) of the Act as the controlling statutory provision, stating that "[f]or jurisdiction to attach . . . the royalty owners must be held engaged in a 'sale in interstate commerce of natural gas for resale'" within the meaning of Section 1(b), and whether royalty owners are so engaged is a question which requires reference to Congressional intent (Appendix C, p. 22).

Despite the Commission's conclusions as to effective exercise of jurisdiction since 1954, the court then stated that the Act "has not heretofore been construed to apply to ordinary lessors," and that the intent of Congress cannot be determined by references to "State law decisions," but "must ultimately be ascertained in the light of regulatory purpose and objective." (Appendix C, pp. 22-23). Nevertheless, the court presumed that Congress used the term "sale" according to its "ordinary" sense, and citing *Burnet* v. *Harmel*, 287 U.S. 103 (1932), found it sufficient for this case that "the royalty owner is not considered, either in common parlance or in conceptions of state law decisions, to be engaged in any 'sale' of gas." (Appendix C, p. 24).

The court noted Commission reliance upon *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965) (the "*Rayne* case"), for conclusions that (a) such local law is not determinative of the meaning of the term

"sale" in the Act, and (b) lack of regulatory control over interests held by royalty owners would create a "regulatory gap." However, the court characterized that case as having "extended FPC jurisdiction over sales of certain leases, although the Act addresses itself . . . to sales of gas." (Appendix C, p. 26). The court then stated that while the *Rayne* case held that lease transfers there involved were the equivalent in economic effect to conventional sales, an "ordinary" lease is neither a "customary" sale, nor its equivalent in economic effect. In the court's view, "the significant fact for a sale in interstate commerce is interstate movement," which in the case of a "typical oil and gas lease," it found lacking (Appendix C, p. 28).

The court then described attributes of a "typical" oil and gas lease, characterized the Commission's "approach" as a theory under which jurisdiction would attach to a lessor upon execution of a lease by virtue of his retention of an economic interest in interstate sales, and rejected such conception by analogies to a "developer of a shopping center," a "patentee," an "owner of farmland," and an "owner of a mine," none of whom, according to the court, become "sellers" merely through an economic interest in the proceeds of a sale (Appendix C, pp. 29-30).

Against this background, the court declared the Commission's ruling "unsound" and stated:

> "We do not think a different result warranted or mandated on the ground that the purpose of the Act is to protect the ultimate beneficiaries against exploitation by natural gas companies. That was indeed the objective of Congress, see *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944). The FPC is to be commended for attempting to further that objective, but it is not sufficient justification upon which to base an expansion of the Act to activities clearly not within its terms." (Appendix C, p. 30).

As otherwise here relevant, the court further found as to the impact of higher prices for consumers, that the record was deficient in that there were "no findings concerning the extent or significance of market price contracts"; that the Commission opinion gave "no concrete indication of whether, in what circumstances, or to what extent, there may be an economically meaningful problem of 'market prices' in excess of ceilings"; but that litigation between producers and royalty owners "may come to involve substantial sums even if pursued so as to recover royalties based on ceilings higher than filed rates." (Appendix C, p. 32)

As to such litigation, the court's "inference" was drawn from the challenge by Mobil and other producers of the Commission's holding that a royalty owner is not limited to the rate filed by the producer. However, the court stated that the record did not focus "on what may be involved in the possibility of recovery of royalty calculated on the basis of 'market prices' higher than ceilings." (Appendix C, p. 33). Thereupon, the court found no "theoretical impediment" to producers being held on the basis of a contract to a royalty payment related to a base higher than the producers' filed rate; indicated it was not persuaded that the maintenance in state or Federal courts of lease controversies between royalty owners and lessees "will undercut the Federal regulatory system" (Appendix C, p. 35); and reversed the Commission decision.

No provision was made for remand to the Commission.

REASONS FOR GRANTING THE WRIT

On the issue of Commission jurisdiction, the decision below conflicts in principle with controlling rules of construction of the Natural Gas Act enunciated by this Court;[6] disposes of an issue of general applicability under

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[6] See *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965); *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954).

that statute which has not been previously considered by this Court; and erroneously decides federal questions now pending in numerous state and federal courts in a way which adversely affects all federally regulated producers of natural gas and, ultimately, all consumers of natural gas sold in interstate commerce for resale.

On the issue of the controlling ceiling rate for royalty interests, the Court of Appeals' conclusions are in conflict with the "filed rate" doctrine applied by this Court and the Courts of Appeals in construction of the Natural Gas Act and similar federal statutes;[7] and would undermine the method of determining natural gas producing industry "area rates" under principles affirmed by this Court.[8]

On all of these issues, the decision below also conflicts with governing principles for judicial review of the factual and evidentiary predicate for an agency's findings and conclusions as to agency jurisdiction;[9] conflicts with principles of this Court's decisions which require remand for further proceedings *if* the predicate of findings or of substantial evidence is deemed deficient by the reviewing court;[10] and thus raises important questions as to the proper application of Section 19(b) of the Natural Gas Act which should be reviewed by this Court.

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[7] See *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951); *Federal Power Commission* v. *Sunray DX Oil Co.*, 391 U.S. 9, 37-38 (1968).

[8] See *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

[9] See *Federal Power Commission* v. *Florida Power & Light Co.*, —— U.S. ——, 92 S. Ct. ——, 30 L. Ed. 2d 600 (1972).

[10] See *Federal Power Commission* v. *United Gas Pipe Line Co.*, 393 U.S. 71 (1968); *Regal Knitwear Co.* v. *National Labor Relations Board*, 324 U.S. 9, 13 (1944); *Federal Communications Commission* v. *Pottsville Broadcasting Co.*, 309 U.S. 134, 145 (1940); *Federal Trade Commission* v. *Sperry & Hutchinson Co.*, —— U.S. ——, 40 U.S. Law Week 4241, No. 70-70 (March 1, 1972).

1. The Reversal of the Commission's Decision as To Its Jurisdiction Conflicts with Controlling Principles for Construction of the Natural Gas Act and Presents Issues of Wide Applicability and Importance Which Should Be Reviewed by This Court.

Federal Power Commission regulation of sales of natural gas in the fields of production currently applies to more than 13,000,000 million cubic feet sold each year and controls revenues exceeding $2.2 billion per year.[11] Of these amounts, more than one-eighth are attributable to the royalty interests. The decisison below applies generally to this economic interest held by all private, nongovernmental owners in all sales of natural gas heretofore regulated by the Commission.

By reversing the Commission's exercise of jurisdiction over the royalty owners' economic interest, the Court of Appeals would bar application of Commission-prescribed rates as the ceiling applicable to that interest and would permit such owners to charge and collect on the basis of higher unregulated prices and "market values" determined by state and federal courts. The result is creation of a new, broad gap in federal regulation heretofore controlling all private interests in sales of natural gas in interstate commerce for resale, a gap through which royalty owners and others may now avoid Commission ceiling rates.

This result was reached through failure of the Court of Appeals to apply properly the controlling principles for construction of the Act set forth in *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965). There, this Court held that determination of a jurisdic-

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[11] See "Sales by Producers of Natural Gas to Interstate Pipeline Companies 1969," Federal Power Commission, December, 1970, Preface page VI, Table A, Domestic Producers. Regulation of these sales, including the economic interests of royalty owners therein, commenced after *Phillips Petroleum Co.* v *Wisconsin*, 347 U.S. 672 (1954).

tional "sale" under the Natural Gas Act cannot be made dependent upon "technical concepts of local law," but turns upon "significant and determinative economic facts" (381 U.S. at 400-401). In this case, the Examiner and the Commission had properly applied this test, focusing precisely and only upon the royalty owners' continuing economic interest in natural gas if, as and when produced; the receipt of payment therefor only upon production and sale; and then only upon the basis of units of production and out of revenues from the sale of those units. Consistent with this Court's opinions, the Commission thus drew the required lines of jurisdiction with meticulous findings, *e.g.*,

> "The basic fact here is the effective retention by the royalty holders of a percentage interest in the gas sold in interstate commerce. While that portion of the royalty contract on which the royalty owners focus, which results in payments prior to the production of gas, may well be nonjurisdictional under the decision in *Panhandle Eastern Pipe Line Co.* v. *Public Service Commission of Indiana*, 337 U.S. 498 1948), the remaining portion of the arrangement, which results in payment to the royalty holder based on the production of natural gas for sale in interstate commerce, seems to us plainly to be jurisdictional." (Appendix D, p. 53).

Consistent with this Court's opinions, the Commission had rejected Hornbook definitions or local decisions not applicable to the Natural Gas Act," pointing out that ". . . a 'natural-gas company' is a person engaged in the 'sale in interstate commerce of [natural] gas for resale' but whether his operations would be classified as a 'sale' under private law is not determinative, *UGI* v. *Continental Oil Co.*, 381 U.S. 392." (Appendix D, p. 54). By such a correct analysis, the Commission held,

> "We conclude that if he has contracted to retain an economic interest in interstate sales, he has joined the other interest owners in such sales and he has

become a seller of natural gas and therefore a natural gas company." (Appendix D, p. 54).

Reversing the Commission, the Court of Appeals noted the controlling principles, but actually reverted to concepts of "local" law in rejecting the Commission's analysis, findings, and conclusions. Instead of focusing on the "significant and determinative economic facts," the court blurred controlling distinctions and sought definitions outside of the considerations of the regulatory purpose and scope of the Natural Gas Act. The court *actually* treated the question as one of jurisdiction over a lease at time of execution, and sought to establish Congressional "intent" by references to lease of a "supermarket" in "a shopping center," patent licenses, tenant farming, mining of iron ore, and interpretation of a tax statute (Appendix C, pp. 29-30).[12] *Cf. Eastern Petroleum Co.* v. *Kerr-McGee Corp.*, 447 F.2d 569 (7th Cir. 1971).

The Court of Appeals' analysis thus is almost a mirror image of the approach to construction of the Act and the arguments rejected by this Court in *United Gas Improvement Co.* v. *Continental Oil Co.*, *supra*, which, up to the instant case, had been interpreted as barring just such constructions of the definitions in Section 2(6) of the Natural Gas Act. See *Continental Oil Co.* v. *Federal Power Commission*, 370 F. 2d 57 (5th Cir. 1966); *J. M. Huber Corp.* v. *Denman*, 367 F. 2d 104 (5th Cir. 1966); *Weymouth* v. *Colorado Interstate Gas Co.*, 367 F. 2d 84, 102 (5th Cir. 1966). This Court's opinion was noted but simply was not followed below.

The construction involved here applies to the "typical" lease and is an interpretation of the Act applicable to

[12] Significantly, the Court of Appeals relied upon a definition of "sale" in a tax case involving mining law, but failed to note that despite various classifications of the royalty owners' economic interest under state oil and gas law, the owner is entitled to percentage depletion under the Internal Revenue Code, just as are other sellers. See Williams & Meyers, *Oil and Gas Law*, §§ 201, 202, 203, 204.9, 301; *Whitehall Oil Co.* v. *Boagni*, 255 La. 67, 229 So. 2d 702 (1969).

all private royalty interests in all regulated sales of natural gas in the fields of production, as the Commission had recognized correctly. The question of whether the Commission-prescribed rate or an unregulated "market value," determined by the various courts, is to control already is pending in more than 290 cases in state and federal courts. If the opinion below should stand, additional suits against regulated sellers can be expected. Therefore, the ultimate result could be that the rate for one-eighth or more of the natural gas sold in interstate commerce for resale would move out of Commission control, to rise with local interpretations as to current "market prices" in the various states of production, to be imposed to control payments on "proceeds" leases and "market value" leases.

Impact of the construction below will fall directly on all producer-sellers, and indirectly on all consumers of natural gas. Under the "area rate" method of regulation,[13] the Commission has assumed payments to the owner of the royalty interest on bases no higher than the rate allowed by the Commission to all other interest owners. The rate for "flowing gas" has been fixed or tested by reference to producers' costs, and the rate for "new gas" has included an allowance for payments equal to, but no higher than, the "area rate." If producers are forced to pay the royalty interest owner on excessive bases higher than the Commission has so allowed in the past, the producers inevitably must seek rate increases; these increases then will follow the flow of gas from the fields of production, through pipeline rates, and local distribution company rates, straight to the bills to ultimate consumers of natural gas. With more than one-eighth of revenues in fields of production so exposed to the vagaries of construction of lease terms and "findings" of current "value" under state law, it is no exaggeration to say that if the opinion below stands, the impact on the

[13] See *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

chain of rate payers can rise to tens of millions of dollars in a matter of months.

A more immediate result will be that if the opinion below should become final, petitioners must seek immediate remand to the Commission of four "area rate" cases now on review and by which the Commission had fixed rates for more than 60 per cent of the natural gas moving in interstate commerce.[14] In determining costs to delimit "zones of reasonableness," to fix rates, and to assess acceptability of settlement agreements in two cases, the Commission used the costing process reviewed in *Permian*, fixed rates, and decided the cases on the assumption that its Opinion No. 562, reviewed and reversed below, was valid and controlling. However, if as the Court of Appeals concludes, all of these rates no longer control the economic interest of the royalty owner, then all area rate determinations by the Commission which are not yet final must be reconsidered by the Commission. Cost determinations, whether used to fix a "pinpoint" cost-based rate or merely to demark the limits of a "zone of reasonableness," will require upward adjustment to cover the claims of the royalty owners and new "values" controlling payments to them. All that has barred these claims to date, and the need to adjust all costs upward, has been Commission Opinion No. 562, which the court below would nullify.

In sum, the opinion below would reverse consistent regulatory treatment of the royalty interest since 1954 and is based on a reversion in principles controlling de-

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[14] Commission Opinion No. 586, pending *sub nom.* Hugoton-Anadarko Area Rate Case (People of the State of California v. FPC), No. 71-1036, Ninth Circuit; Opinion No. 595, pending *sub nom.* Texas Gulf Coast Area Rate Case (Public Service Commission of New York v. FPC), No. 71-1828, D.C. Circuit; Opinion No. 598, pending *sub nom.* Southern Louisiana Area Rate Case (Placid Oil Co. v. FPC), No. 71-2761, Fifth Circuit; and Opinion No. 607 (Other Southwest Area), pending *sub nom.*, Shell Oil v. FPC, No. 72-1114, Fifth Circuit.

cision and review of questions of jurisdiction under a federal regulatory statute.[15] The opinion notes but does not actually follow this Court's opinions, reverses the Commission on a question of jurisdiction directly affecting all producers of natural gas, and disposes of questions pending in numerous fora which, if decided as the court below would permit, mean unnecessary, excessive payments attributable to a heretofore regulated economic interest, and unnecessary, but inevitable, increases in natural gas rates. Questions of major public importance in the administration of the Natural Gas Act, therefore, are raised and should be reviewed by this Court.

2. Conclusions of the Court of Appeals and of the Commission as to the Controlling Ceiling Rate Conflict with the "Filed Rate" Doctrine under Decisions of This Court and the Courts of Appeals.

Before the Commission, three choices of the controlling, effective ceiling rate for the royalty interest were advocated: (1) the rates in effect on June 7, 1954 until lawfully changed under Section 4; or (2) the specific "filed rates" and rate increases filed by the well or plant operator, as lawfully changed from time to time after June 7, 1954 under orders effective and final under Section 4 of the Natural Gas Act; or (3) the "area rate," even if higher than such a "filed rate," applied retroactively and

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[15] Contrary to the opinion below, the Commission correctly found that it effectively has regulated the economic interest actually involved since 1954, and that continued regulation was consistent with and required by the purposes and regulatory objectives of the Act (Appendix D, p. 56). Conversely, the Court of Appeals substitutes the court's "findings" for the deference due these agency findings and conclusions, violating principles of *United Gas Improvement Co.* v. *Continental Oil Co., supra*, and the teaching of *Gray* v. *Powell*, 314 U.S. 402 (1941); *National Labor Relations Board* v. *Hearst Publications, Inc.*, 322 U.S. 111, 129-130 (1944); *Securities and Exchange Commission* v. *New England Electric System*, 384 U.S. 176 (1966); *First National Bank* v. *Dickinson*, 396 U.S. 122 (1969); and *United States* v. *Drum*, 368 U.S. 370, 375-376 (1962).

prospectively, once fixed by a Commission "area rate" decision applicable to the particular sale.

The Commission chose the latter (Appendix D, pp. 57-58), and Mobil and others sought review on the grounds that (1) such "area rates" frequently are higher than "filed rates" for past periods, and sometimes are higher than prices allowed under producers' long-term contracts dating from the 1950s and early 1960s; and (2) any retroactive application of "area rates" violated the "filed rate" doctrine and settled construction of the Act limiting such changes to prospective application only.

While reversing the Commission on jurisdiction, the Court of Appeals indicated its disagreement with the positions of both the producer-petitioners and the Commission below (Appendix C, pp. 32-35). The Court indicated its view that there was "no theoretical impediment" to producers being held on "the basis of contract" (Appendix C, pp. 33-34), stated that it was "puzzled" and "uneasy" as to the Commission's "conception" and "analysis," and ignored controlling constructions of Section 4.

Nevertheless, if as the Commission held, the interest is jurisdictional and controlled by operators' filings, then the *only* lawful rate is that which has been effective, from time to time, by proper filing of increases by the operators under Section 4, and there can be no retroactive increase of those rates solely for the royalty interest. Rates actually so effective in the past would apply equally to the benefit of all interest owners under the operators' filing, and a higher "area rate" could apply prospectively only and equally to all interest owners.

The views expressed by the Court of Appeals and the Commission's conclusion on the question conflict with the holdings that (1) there can be no retroactive changes of the rates made effective without suspension under Section 4 of the Natural Gas Act (*Federal Power Commission* v.

Hope Natural Gas Co., 320 U.S. 591 (1944)); and (2) the filing of rates and changes of rates in accordance with procedures such as those in Section 4 is the only means of establishing a legally effective rate, and final rates so established control in subsequent or collateral proceedings (*Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951); *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 339-340, 343 (1956)). The conclusions below thus also conflict with prior consistent application of this "filed rate" doctrine under the Natural Gas Act by the Fifth Circuit (*Socony Mobil Oil Co.* v. *Brooklyn Union Gas Co.*, 299 F. 2d 692, 694-695 (5th Cir.), cert. den., 371 U.S. 887 (1962)); the Third Circuit (*Shell Oil Co.* v. *Federal Power Commission*, 334 F. 2d 1002, 1009 (3rd Cir. 1964)); the Tenth Circuit (*Cities Service Gas Producing Co.* v. *Federal Power Commission*, 233 F. 2d 726, 730 (10th Cir. 1956)); and the District of Columbia Circuit (*Episcopal Theological Seminary* v. *Federal Power Commission*, 269 F. 2d 228, 233 (D.C. Cir.), cert. den., 361 U.S. 895 (1959)).

This issue also applies generally to all jurisdictional sales by producers and is the threshold question in resolving all of the controversies over the controlling ceiling rate under the Natural Gas Act. Therefore, with the issue of jurisdiction, the questions so raised should be reviewed by this Court.

3. The Court of Appeals Erroneously Rejected the Agency's Predicate for Its Conclusion That It Had Jurisdiction and, in Any Event, Should Have Remanded If the Court Concluded the Commission's Findings or Evidence Were Deficient.

As shown *supra*, the Court of Appeals rejected the Commission's findings and conclusions upon the "significant and determinative economic facts," upon the economic effect of the *part* of the lessor-lessee transaction held to be jurisdictional, and upon the construction required by

the regulatory purposes and objectives of the Act (Appendix C, pp. 28-34). In so doing, the court stepped outside of its role of review under Section 19(b) of the Act, particularly in so rejecting the formal findings of the Examiner and the Commission underlying the conclusion of jurisdiction. The errors thus are similar to those found by this Court in its review and reversal of a decision by the Fifth Circuit involving jurisdiction under the Federal Power Act in *Federal Power Commission* v. *Florida Power & Light Co.*, —— U.S. ——, 92 S.Ct. ——, 30 L.Ed. 2d 600 (1972).

Beyond this, if the Commission's findings and the evidence supporting those findings actually are deficient,[16] the proper course is a reversal and remand to the Commission. *Federal Power Commission* v. *United Gas Pipe Line Co.*, 393 U.S. 71 (1968); *Regal Knitwear Co.* v. *National Labor Relations Board*, 324 U.S. 9, 13 (1945); *Federal Communications Commission* v. *Pottsville Broadcasting Co.*, 309 U.S. 134, 145 (1940). This course should have been followed even if, in the view of the Court of Appeals, it was only laying bare "an error of law." *Federal Power Commission* v. *Idaho Power Co.*, 344 U.S. 17, 20 (1952).

The Court of Appeals also erred in substituting its views, based on wholly extraneous concepts such as those used in state mining law or shopping center development, for the Commission's findings and conclusions. Similarly, on the question of Congressional "intent," the court erred

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[16] We, of course, do not agree that there are any such deficiencies requiring or permitting reversal of the Commission under Section 19(b). On the merits, we would be prepared to show that the record, the findings, and the available materials as to Congressional intent all support the Commission's conclusions on jurisdiction, not those of the court below. Nevertheless, if this Court should conclude that the analysis, findings, or substantial evidence supporting the Commission's conclusions on the jurisdictional issue are defective, then we would urge that the proper course would be to set aside the opinions and orders on review and to remand for further agency proceedings.

in failing to refer to actual content of the record and cited materials pertinent to that question. Its analysis and process of review thus did not follow the strictures on "scope of review" applicable to proceedings under Section 19(b) of the Act. See *Permian Bason Area Rate Cases, supra.*

As in the *Florida Power & Light Co.* case, this case thus raises questions of the proper role of the court in review of an agency determination that it has jurisdiction. In this instance, findings involving "economic effect" and a rate regulatory program already operative for almost eighteen years have been overturned with no remand to the agency. Both the result and the process by which the Court of Appeals reached such a result thus present questions that should be reviewed by this Court.

4. The Decision Below Would Permit Diversion of Funds Needed to Alleviate a National Shortage of Natural Gas to Windfall Payments to Owners Who Bear No Costs.

The Commission has found that there is "a critical shortage of gas in the United States." [17] In the hope of alleviating that shortage, the Commission has taken a number of steps designed to increase the capital available to producers for exploration and development on existing leases and new leases, including allowance of higher rates as "incentives" for immediate and continued use of all available funds for these purposes.[18] The opinion below, however, is a major blow to that program.

The "royalty" owner bears no costs and does not engage in exploration and development. Owners of the working interests—the producer "operators"—bear the costs of

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[17] Commission Opinion No. 598, —— FPC —— (Issued July 16, 1971, p. 23 mimeo. ed.), on review *sub nom.* Southern Louisiana Area Rate Case (Placid Oil Co. v. FPC), No. 71-2761, Fifth Circuit.

[18] See, *e.g.*, opinions cited in fn. 14, *supra.*

production and must acquire and commit the capital needed for exploration and development. This risk capital is, in large measure, generated internally from revenues from current sales. Under the Commission's current method of fixing rates, the capital requirements, and the availability of funds, have been computed on the assumption that the royalty owners' share of those revenues will be based on rates at least no higher than the Commission-prescribed "area rates." Yet, the opinion below would permit courts in collateral actions to substitute their determinations of "current market value" as they see fit.[19]

As this happens, two results would follow, neither of which would be consistent with the purposes and regulatory objectives of the Natural Gas Act: (1) the increased rates for the royalty owners would require corresponding increases in producers', pipelines', and distributors' rates, with no resultant commitment of funds to the program to alleviate the gas shortage; or (2) to the extent that "lag" or other delay in rate increases causes producers or pipelines to absorb any of the excess payments to royalty owners, funds for exploration and development would have to be diverted to cover these payments. Since more than one-eighth of the revenues in fields of production are exposed by the opinion below, the ultimate result would be windfall payments to royalty owners with no corresponding benefit whatever to minimize the national shortage of natural gas.

These considerations were a part of the Commission's assessment of "economic" facts and the regulatory purposes involved. The Court of Appeals erroneously rejected those conclusions, exposing a national supply program to erosion in scores of state courts. The result cannot be reconciled with the Act or applicable principles of con-

[19] The record shows that at least one state court has already concluded that the royalty owner should be paid on the basis of "market value" even where a payment clause provides only for payment of a share of "proceeds."

struction of such a federal statute. In any event, the impact is such that early resolution of the questions presented to this Court is more than warranted.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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March 13, 1972

Supreme Court, U. S.
FILED

IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No. 71-1169

MOBIL OIL CORPORATION,
Petitioner,

v.

CARL F. MATZEN, *et al.*,
Respondents.

APPENDICES TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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APPENDIX A

List of Respondents Included in Designation "Carl F. Matzen, *et al.*"

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W. Harold Parker	Route 4, Guymon, Oklahoma
Earl J. Peachey and Thelma Pauline Peachey	Hugoton, Kansas
Merl J. Peachey and Dorothy May Peachey	Hugoton, Kansas
Marian S. Pfeiffer	814 Cresta Road Colorado Springs, Colorado 80906
Charles C. Pottorff	Severy, Kansas
H. E. Randle and Helen M. Randle	606 South Oak Street Pratt, Kansas
Lloyd Randle and Mabel Axline and Wilbur Randle and Adeline Murrell and Jack P. Randle	c/o Lloyd Randle Route 2 Pratt, Kansas
Elwyn Ray	Box 455 Hugoton, Kansas 67951
Archie F. Roehr	Box 964 Liberal, Kansas
Clarence P. Roehr	15 W. 9th Street Liberal, Kansas
Rooks County State Bank, Account of Estelle Perrill	Woodston, Kansas

Pearle Schneider	1012 Duncan Pampa, Texas
K. E. Sentney	211 Wolcott Building Hutchinson, Kansas
Dollie Shultz	Box 212 Nampa, Idaho
Russell N. Smith	P. O. Box 815 Hugoton, Kansas
Russell N. Smith and Frances May Smith	Hugoton, Kansas
Catherine C. Spangler	Box 45 Veneta, Oregon
August Stamler	Hugoton, Kansas
Haven H. Stevens	Box 827, Hooker, Oklahoma
Ralph B. Stewart	3228 Travis, Amarillo, Texas
Richard M. Stewart	5212 Berget Drive Amarillo, Texas
Price Stout and Alice Stout	Rolla, Kansas
Mae S. Summers	2811 North Madison Hutchinson, Kansas
Frank Thomas and Lavern Thomas	Route 2, Box 65 Hugoton, Kansas
Frank H. Thompson	Rolla, Kansas
Will C. Toole	Hugoton, Kansas
Fred H. Walkemeyer and Frances Walkemeyer	Route 2, Hugoton, Kansas
Robert J. Walker	Hugoton, Kansas
W. A. Ward	Box B640, Hugoton, Kansas
Frances Y. C. Warner	708 North Perry Street Titusville, Pennsylvania
S. R. Webb or Verla Webb	Route 2, Box 60 Hugoton, Kansas
Gladys Weiser	2609 Sennett Wichita, Kansas
Thelma L. Wells and Norman L. Wells	11066 Linden Street Lynwood, California

Howard L. Willis and Lenora Willis	RFD, Hugoton, Kansas
Harry A. Wilson and/or L. Oleta Wilson	Hugoton, Kansas
H. O. Winters	3125 Englewood Terrace Noland Addition Independence, Missouri
Roy F. Hammett or Bessie L. Hammett	700 Polk Street Topeka, Kansas
Joe N. Hulpieu	908 2nd Ayenue Dodge City, Kansas
Harold W. Joslin, Agent and Attorney in Fact for Richard Phillip Joslin and Leone Joslin	130 Hidden Valley Lane San Anselmo, California
Fred L. Dold and Lena C. Dold, Co-Trustees under the Will of Fred W. Dold, Deceased	421 East 21st Street Wichita, Kansas
T. A. Dudley and Frank Mantzke, Special Co-Administrators of the Estate of Martha L. Isom, Deceased	Hugoton, Kansas
John O. Ertz and Rosabelle Ertz	Hugoton, Kansas
First National Bank in Larned Account of Ardis B. Bennett	Larned, Kansas
Grady E. Martin	Box 921 Truth or Consequences, New Mexico
John W. McNutt	Haviland, Kansas
Ella M. Paden	Hugoton, Kansas
Willo Ponder and Joseph P. Ponder, Jr.	Hugoton, Kansas
T. D. Presley	Rolla, Kansas
John E. Ray	Route 1, Box 186 Liberal, Kansas
H. C. Sturgeon and Lottie L. Sturgeon	Hugoton, Kansas
Charles Sullivan, Administrator for W. H. Sullivan	Rolla, Kansas
Orval R. Toole	Hugoton, Kansas

AND—

Carl F. Matzen	1115 N. Edgemoor Wichita 8, Kansas
Earl R. Anderson	Box 91 Hugoton, Kansas
Doris M. Anderson	Box 91 Hugoton, Kansas
J. I. Cullison	Box 315, Satanta, Kansas
John H. Burnside	111 West Walnut Garden City, Kansas
Olive Bell Burnside	111 West Walnut Garden City, Kansas
Maxine Campbell	Lakin, Kansas
Charles M. Dudley	1450 Chestnut Place Boulder, Colorado
Archie F. Rooney	Satanta, Kansas
Judith Rooney	Satanta, Kansas
Cecil W. Sturgeon	P. O. Box 698 Dodge City, Kansas 67801
Sullivan Investments, Inc.	Ulysses, Kansas
Sullivan Realty, Inc.	Box 946, Ulysses, Kansas
J. W. Teeter	218 W. Flower Ulysses, Kansas

The immediately foregoing fourteen parties, individually, on their own behalf and also as representatives for and on behalf of the other members of the class of landowners similarly situated owning lands subject to oil and gas leases owned and operated by Socony Mobil Oil Company, Inc., gas from which is sold by it to Cities Service Gas Company under contract dated June 17, 1946, between Cities Service Gas Company, a corporation, and Magnolia Petroleum Company, a corporation, and all amendments thereto. This class consists of approximately 600 separate parties.

AND—

Howard Miller, Executor of the Last Will and Testament of John Q. Adams	Satanta, Kansas

AND—

The Land and Royalty Owners of Louisiana

APPENDIX B

Judgment of the United States Court of Appeals for the District of Columbia Circuit, No. 23,463, *et al.*, *Mobil Oil Corporation, et al* v. *Federal Power Commission*, December 17, 1971

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

SEPTEMBER TERM, 1971

No. 23,463

Mobil Oil Corporation, Petitioner

v.

Federal Power Commission, Respondent

Panhandle Eastern Pipe Line Company, Carl F. Matzen, et al., Cities Service Oil Company, Philadelphia Gas Works Division of UGI Corporation, Intervenors

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No. 23,491

J. M. Huber Corporation, Petitioner

v.

Federal Power Commission, Respondent

Philadelphia Gas Works Division of UGI Corporation, Shell Oil Company, Intervenors

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No. 23,511

Western Natural Gas Company, Petitioner

v.

Federal Power Commission, Respondent

Philadelphia Gas Works Division of UGI Corporation, Carl F. Matzen, et al., Intervenors

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No. 23,633

Amoco Production Company, Petitioner

v.

Federal Power Commission, Respondent

Philadelphia Gas Works Division of UGI Corporation, Carl F. Matzen, et al., Intervenors

---

No. 23,654

The Land and Royalty Owners of Louisiana, Petitioner

v.

Federal Power Commission, Respondent

Mobil Oil Corporation,
Philadelphia Gas Works Division of UGI Corporation, Intervenors

---

No. 24,051

Carl F. Matzen, et al., Petitioners

v.

Federal Power Commission, Respondent

Mobil Oil Corporation, Philadelphia Gas Works Division of UGI Corporation, Cities Service Oil Co., Panhandle Eastern Pipe Line Co., Atlantic Richfield Company, Western Natural Gas Co., Shell Oil Company, Intervenors

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No. 24,180

William Harvey Denman, et al., Petitioners

v.

Federal Power Commission, Respondent

Cities Service Oil Company, Panhandle Eastern Line Co., Philadelphia Gas Works Division of UGI Corporation, Shell Oil Company, J. M. Huber Corporation, Intervenors

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Petitions for Review of Order of the Federal Power Commission

Before: LEVENTHAL, ROBINSON and MACKINNON, Circuit Judges

JUDGMENT

These cases came on to be heard on the record from the Federal Power Commission, and were argued by counsel. Upon consideration thereof, it is

ORDERED AND ADJUDGED by this Court that the order of the Federal Power Commission on review herein is hereby reversed.

PER CURIAM

FOR THE COURT:

/s/ Nathan J. Paulson
NATHAN J. PAULSON, Clerk

APPENDIX C

Opinion of the United States Court of Appeals for the District of Columbia Circuit, No. 23,463, *et al.*, *Mobil Oil Corporation, et al.* v. *Federal Power Commission*, December 17, 1971

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 23,463

MOBIL OIL CORPORATION, PETITIONER

v.

FEDERAL POWER COMMISSION, RESPONDENT

PANHANDLE EASTERN PIPE LINE COMPANY,
CARL F. MATZEN, ET AL.,
CITIES SERVICE OIL COMPANY,
PHILADELPHIA GAS WORKS DIVISION OF UGI
CORPORATION, INTERVENORS

No. 23,491

J. M. HUBER CORPORATION, PETITIONER

v.

FEDERAL POWER COMMISSION, RESPONDENT

PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION,
SHELL OIL COMPANY, INTERVENORS

No. 23,511

WESTERN NATURAL GAS COMPANY, PETITIONER

v.

FEDERAL POWER COMMISSION, RESPONDENT

PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION,
CARL F. MATZEN, ET AL., INTERVENORS

No. 23,633

AMOCO PRODUCTION COMPANY, PETITIONER

v.

FEDERAL POWER COMMISSION, RESPONDENT

PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION,
CARL F. MATZEN, ET AL., INTERVENORS

No. 23,654

THE LAND AND ROYALTY OWNERS OF LOUISIANA, PETITIONER

v.

FEDERAL POWER COMMISSION, RESPONDENT

MOBIL OIL CORPORATION,
PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION,
INTERVENORS

No. 24,051

CARL F. MATZEN, ET AL., PETITIONERS

v.

FEDERAL POWER COMMISSION, RESPONDENT

MOBIL OIL CORPORATION,
PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION,
CITIES SERVICE OIL COMPANY,
PANHANDLE EASTERN PIPE LINE COMPANY,
ATLANTIC RICHFIELD COMPANY,
WESTERN NATURAL GAS COMPANY,
SHELL OIL COMPANY; INTERVENORS

No. 24,180

WILLIAM HARVEY DENMAN, ET AL., PETITIONERS

v.

FEDERAL POWER COMMISSION, RESPONDENT

CITIES SERVICE OIL COMPANY,
PANHANDLE EASTERN PIPE LINE COMPANY,
PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION,
SHELL OIL COMPANY,
J. M. HUBER CORPORATION, INTERVENORS

Petitions for Review of Order of the Federal Power Commission

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Decided December 17, 1971

Mr. Carroll L. Gilliam, with whom *Messrs. Philip R. Ehrenkranz* and *William H. Emerson* were on the brief, for petitioners in Nos. 23,463, 23,511 and 23,633; also argued for intervenor Cities Service Oil Company in Nos. 23,463, 24,051 and 24,180. *Mr. William J. Grove* entered an appearance for petitioner in No. 23,633.

Mr. Sherman S. Poland, with whom *Messrs. James B. Reed* and *Daniel F. Collins* were on the brief, for petitioner in No. 23,491 and intervenor J. M. Huber Corporation in No. 24,180.

Mr. Dale M. Stocky for petitioners in No. 24,051 and intervenors Carl F. Matzen, et al., in Nos. 23,463, 23,511 and 23,633.

Mr. H. H. Hillyer, Jr., for petitioner in No. 23,654.

Mr. Israel Convisser, Attorney, Federal Power Commission, with whom *Messrs. Gordon Gooch*, General Counsel, *Leo E. Forquer*, Assistant General Counsel, Federal Power Commission, and *Peter H. Schiff*, Solicitor, Federal Power Commission at the time the brief was filed, were on the brief, for respondent.

Mr. Dan A. Bruce, with whom *Mr. Thomas G. Johnson* was on the brief, for intervenor Shell Oil Company in Nos. 23,491, 24,051 and 24,180.

Mr. Graydon D. Luthey was on the brief for intervenor Cities Service Oil Company in Nos. 23,463, 24,051 and 24,180.

Mr. Charles E. McGee was on the brief for intervenor Atlantic Richfield Company in No. 24,051. *Mr. John T. Ketcham* also entered an appearance for intervenor Atlantic Richfield Company in No. 24,051.

Mr. James J. Flood, Jr., entered an appearance for intervenor Panhandle Eastern Oil Company in Nos. 23,463, 24,051 and 24,180.

Before LEVENTHAL, ROBINSON and MACKINNON, *Circuit Judges.*

Opinion for the Court filed by LEVENTHAL, *Circuit Judge.*

Concurring opinion filed by MACKINNON, *Circuit Judge,* at p. 26.

LEVENTHAL, *Circuit Judge:* These are petitions for review of an order of the Federal Power Commission (FPC), accompanied by its opinion No. 562, 42 FPC 164, which determined and declared that the royalty provisions of oil and gas leases constitute sales of natural gas for resale in interstate commerce subject to the Natural Gas Act, and that the landowners are subject to regulation as natural gas companies whose sales are covered by the filings of their lessees, the producer-operators. We reverse.

Facts and Prior Proceedings

In *J. M. Huber Corp. v. Denman,* 367 F.2d 104 (5th Cir. 1966), the court agreed with landowners that the particular oil and gas leases they executed required the gas-producer lessees to make royalty payments based on the current "market price" of the gas and not, as lessees contended, on the actual price received by the producer for the gas.

The market price was not determined because the lessor's claim, for a royalty based on a market price of 23¢ per mcf for gas run since 1946, presented "a serious question whether a Court, state or federal, either initially or ultimately, may allow any amounts fixed by jury, court, or both as increased royalty payments without express prior approval of the Federal Power Commission if, as would these, the price thus fixed would exceed levels prescribed by the FPC." (367 F.2d at 110, 111.) The

court took account of the public interest issues involved, and directed a reference by the parties to the FPC under the doctrine of primary jurisdiction for that agency to make an initial determination of its jurisdiction over rates to be paid for gas royalty.

Thereafter the royalty owner-landholders in *Huber* petitioned the FPC for a declaratory order disclaiming jurisdiction over royalty payments. Several lessee-producers involved in similar litigation filed complaints seeking an FPC determination that such royalties are subject to FPC jurisdiction. The FPC consolidated the dockets for hearing and decision. After prehearing conferences and evidentiary hearings, the presiding examiner concluded that the royalty owners are "natural gas companies as defined in the Natural Gas Act"[1] and that a royalty owner seeking an increase in royalty payment must apply to the FPC beforehand. The Commission affirmed in part by a vote of 3-2. It declared that "the royalty provisions of oil and gas leases constitute sales of natural gas for resale in interstate commerce subject to all the provisions of the Natural Gas Act."[2] However, it held that the royalty owners need not make a separate filing to the FPC; the producers' filings were held to cover the royalty "sales" adequately for regulatory purposes.[3]

Petitions to review have been filed both by Mobil Oil Corporation and other producers, and by royalty owners, and the cases have been consolidated. The royalty owners challenge the FPC's jurisdictional decision. The producers challenge the contemporaneous ruling, referred

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[1] R. 4459; 42 FPC at 198.

[2] R. 5045; 42 FPC at 174.

[3] *Id.*

to in more detail hereafter, that the royalty owners are entitled to payment on the basis of their contract terms even when higher than the producer's effective rate, provided no breach of ceiling prices is wrought. We find error in the jurisdictional determination.

Ruling That The FPC Does Not Have Jurisdiction Over The Payment Of Royalties Under A Typical Natural Gas Lease

In the FPC's order of June 23, 1967, setting a hearing on whether royalty payments to the lessors are subject to its jurisdiction, the Commission authorized receipt of evidence relating to general industry contracting practices with respect to gas leases so as to be more fully informed as to the general background of the problem and possible economic and legal consequences before making its determination.

Evidence was introduced on industry practice with respect to oil and gas lease agreements. The evidence is well summarized in the opinion of the Presiding Examiner. He focused on the development wherein the landowner has sometimes reserved a royalty of a percentage of the physical hydrocarbon recovered (for oil), has sometimes reserved a royalty of a percentage of the proceeds thereof, and has sometimes reserved a royalty of a percentage of the "market value" thereof at the well or in the field. This portion of the Examiner's opinion provides useful background information and is set forth in an Appendix to this opinion.

The Commission found one "basic fact" determinative of the jurisdictional issue: "the effective retention by the royalty holders of a percentage interest in the gas sold in interstate commerce." This led to the conclusion "that if he has contracted to retain an economic interest in interstate sales, he has joined the other interest owners

in such sales and he has become a seller of natural gas and therefore a natural gas company."[4]

For jurisdiction to attach under the Natural Gas Act, the royalty owners must be held engaged in a "sale in interstate commerce of natural gas for resale." Section 2(6) of the Act defines a "natural gas company" to mean "a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale."[5] Section 1(b) of the Act provides, 15 U.S.C. § 717(b):

> "The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas."

Whether landowners or other royalty owners are engaged in the "sale" of natural gas in interstate commerce for resale within the meaning of § 1(b) of the Act must be determined by reference to the intention of Congress.

The Act was passed in 1938 and it has not heretofore been construed to apply to ordinary lessors. While inaction is not controlling on intent, the widespread assumption and acquiescence therein, including administrative and legislative acquiescence, extending over such a great period of time is not lightly to be brushed aside.

The intention of Congress cannot be conclusively determined by reference to concepts and classifications un-

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[4] 42 F.P.C. at 172.

[5] 15 U.S.C. § 717a(6).

der state law decisions normally disposing of "private" controversies. *United Gas Improvement Co.* v. *Continental Oil Co.*, [the *Rayne Field* case] 381 U.S. 392, 400 (1965).[6]

It must ultimately be ascertained in the light of regulatory purpose and objective. But as a point of departure we may properly begin with the presumption that Congress, like other legislatures, has in mind the ordinary, usual, and natural sense of a word like "sale."[7] This canon is given reinforcement for this term because "sale" was not one of the terms for which Congress provided an express or supplemental definition in § 2 ("Definitions") of the Natural Gas Act.[8]

We have no need to pursue the intricacies of oil-and-gas law, or to take note of the way in which state law concepts vary in describing the interests created by oil and gas leases.[9] It suffices for this case that generally

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[6] Certainly Congress did not intend to create a state checkerboard of federal regulation and non-regulation depending on the varying concepts under local law of the leaseholder's interest.

[7] McNally v. Hill, 293 U.S. 131 (1934); see Old Colony RR v. Comm'r, 284 U.S. 552, 560 (1932).

[8] 15 U.S.C. § 717a.

[9] Among the classifications found by one text writer, with numerous citations to each one (omitted here) are: profit *a prendre*, corporeal hereditament, incorporeal hereditament, an estate in land, not an estate in land, an estate in oil and gas, not an estate in oil and gas, a servitude, a chattel real, real estate, interest in land, not an interest in land, personal property, a freehold, a tenancy at will, property interest, and the relation of landlord and tenant. 1A W. SUMMERS, LAW OF OIL AND GAS § 152 at 371-374 (2d ed. 1954). He concludes, "Perhaps sometime courts and legislatures will recognize the fact that oil and gas leases are

the royalty owner is not considered, either in common parlance or in conceptions of state law decisions, to be engaged in any "sale" of gas.[10] As to state law we refer to Judge Brown's discussion in *Huber*.[11] The lease terms give the lessee all possessory interests in gas produced during the life of the lease, including full right of sale.

The general understanding of lack of any "sale" by the royalty owner, an understanding rooted in state law concepts, is underscored by the opinion in *Burnet v. Harmel*, 287 U.S. 103 (1932) decided only a few years before passage of the Natural Gas Act. While that opinion interprets a tax statute, there is pertinence in Justice Stone's discussion of the lack of incidents of a "sale" by the royalty owner, both in technical terms and common understanding. See 287 U.S. at 107:

> [T]he statute speaks of a "sale," and these leases

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different from other forms of contracts and conveyances, and that the interests created by them cannot be properly classified under common interests in property, and will speak of such interests as the interest of an oil and gas lessee. . . ." *Id.* at § 153, p. 382.

[10] We put to one side any special case of a landowner who takes a share of the gas produced as his royalty and resells it.

[11] See 367 F.2d at 113-114:

"[The lessors make] the very simple, yet profound, contention that there can be no 'sale' of gas by royalty owners since they have no gas to sell. And this seems to be true as a matter of oil and gas law, whether based on the ownership-in-place concept followed by Texas and others or on non-ownership theories of other jurisdictions. For all agree that as the gas leaves the well-mouth, the entire ownership of the gas is in the lessee, none being reserved in the lessor."

Judge Brown's citations reveal that even in Texas, where a lease constitutes a present sale of all the gas in place, the royalty owner possesses some property right in the minerals.

> would not generally be described as a "sale" of the mineral content of the soil, using the term either in its technical sense or as it is commonly understood. Nor would the payments made by lessee to lessor generally be denominated the purchase price of the oil and gas. By virtue of the lease, the lessee acquires the privilege of exploiting the land for the production of oil and gas for a prescribed period; he may explore, drill, and produce oil and gas if found. Such operations with respect to a mine have been said to resemble a manufacturing business carried on by the use of the soil, to which the passing of title of the minerals is but an incident, rather than a sale of the land or of any interest in it or in its mineral content. *Stratton's Independence* v. *Howbert*, 231 U.S. 399, 414, 415; see *Von Baumbach* v. *Sargent Land Co.*, 242 U.S. 503, 521.[12]

The Court referred to its rule of long-standing, that "payments by lessees to lessors under mining leases were not a conversion of capital, as upon a sale of capital assets, but were income to the lessor, like payments of rent." *Id.* at 108.

The FPC's opinion stated "it would be senseless to attempt to determine what is a natural gas company and what is a sale on the basis of Hornbook definitions or local decisions not applicable to the Natural Gas Act. . . . For purposes of the Act, a 'natural gas company' is engaged in 'the sale in interstate commerce of [natural] gas for resale' but whether his operations would be classified

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[12] Von Baumbach v. Sargent Land Co. is one of the Minnesota Royalty Cases involving state leases of iron ore lands. The leading case thereon points out that mineral leases were developed under the law of tenancy and not through the law of sales. Thus the miner never got his title to his mineral through a sale by the owner but rather as a product of the use for which rent was paid and title was acquired by an appropriate use of the leased premises. State v. Evans, 99 Minn. 220, 108 N.W. 958, 906 (1906).

as a 'sale' under private law is not determinative, *U.G.I. v. Continental Oil Co.*, 381 U.S. 392." (R. 5041).

In *UGI v. Continental Oil Co., supra,* referred to as the *Rayne Field* case, the Supreme Court extended FPC jurisdiction over sales of certain leases, although the Act addresses itself, in terms, to sales of gas. Sound analysis of that case requires development of its background.

In *Phillips Petroleum Co v. Wisconsin,* 347 U.S. 672 (1954), the Court held that FPC had jurisdiction over "well-head" sales of natural gas by independent producers to interstate pipeline companies for resale in interstate commerce. As the *Phillips* opinion made clear (347 U.S. at 677) the producers admitted "as they must" that they were engaged in "the sale in interstate commerce of natural gas for resale" and hence came within the basic coverage of § 1(b). The issue was whether the sales of an independent producer were excluded from regulation by the ultimate, and negative, clause of § 1(b) excluding "the production or gathering of natural gas." The Court rejected the contention of exclusion, in view of the Act's text and legislative history, including notably the Federal effort to plug the "gap" in regulation of the natural gas industry created by decisions prohibiting state regulation of interstate commerce aspects. The Court found "a congressional intent to give the Commission jurisdiction over the rates of all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company." [13]

In *Rayne Field,* an interstate pipeline company made arrangements to buy the producers' leasehold interests in the lands in which the natural gas was located, instead of buying the gas produced directly. The gas reserves

[13] See 347 U.S. at 682.

in Rayne Field were proven and the field was substantially developed. The Court noted "The provisions of the lease-sale agreements were such that they were very close in economic effect to conventional sales of natural gas." (381 U.S. at 396). The Court concluded (p. 401):

> "The sales of leases here involved were, in most respects, equivalent to conventional sales of natural gas which unquestionably would be subject to Commission jurisdiction under *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672. . . . [I]t is perfectly clear that the sales of these leases in Rayne Field, a proven and substantially developed field, accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other States. That is the significant and determinative economic fact. To ignore it would substantially undercut *Phillips*. . . .[14]

It is in this context, of a transaction that was in form a lease of reserves but in economic impact the equivalent of "conventional sales of natural gas" that the Court, in upholding FPC jurisdiction to avoid "gaps" in the regulatory framework, stated (381 U.S. at 400):

> "A regulatory statute such as the Natural Gas Act would be hamstrung if it were tied down to technical concepts of local law." *Rayne Field, supra,* 381 U.S. at 400.

These opinions were written with full awareness of the significance, in commercial and regulatory terms, of the sales of gas by independent producers to interstate

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[14] The FPC's decision in *Rayne Field* observed that it "would exalt form over substance, would give greater weight to the technicalities of contract draftsmanship than to the achievement of the purposes of the Natural Gas Act, and would impair our ability to control the price received for gas sold to the pipelines in interstate commerce to the detriment of the ultimate consumer" to hold that it had no jurisdiction. 29 FPC 249, 256, *quoted at* 381 U.S. at 398.

pipeline companies. In establishing a Congressional intent to regulate those sales the Court began, in *Phillips* with what were plainly and admittedly "sales in interstate commerce of natural gas." This was fortified when *Rayne Field* extended coverage to producers' sale of their leases to interstate pipelines, for that extension was on the ground that these lease transfers were the equivalent "in economic effect to the concept of conventional sales" and such conclusion was required so as not to open gaps in Federal regulation. In both cases the Court did not undercut, it rather underlined, the need for a jurisdictional foundation in "sales in interstate commerce"—plain and admitted in *Phillips,* and existing through economic equivalent in *Rayne Field.*

When we come to an ordinary lease by the landowner to the producer there is neither a "customary" sale in interstate commerce nor its equivalent in economic effect. Such a lease is a transaction that is itself customary and conventional, but one that precedes the "conventional" sales in interstate commerce with which Congress was concerned, indeed even precedes the "production and gathering" which § 1(b) visualized as preceding the sale in interstate commerce over which jurisdiction was being established.

Turning to the "significant and determinative economic facts," basically the significant fact for a sale in interstate commerce is interstate movement either by the seller, prior to or in connection with the sale, or by the purchaser, typically an interstate pipeline company, subsequent to or in connection with the sale. In the case of a typical oil and gas lease, there is no such interstate movement by either the transferor or transferee.

In *Rayne Field,* the gas reserves were known and had been substantially developed by or in behalf of the lessees-producers. A gas lease, however, transfers only the right

to explore, develop, and market if exploration is successful; no royalty is paid if no gas is discovered. In *Rayne Field* the lease-buyers were interstate pipeline companies —clearly "natural gas companies" under the Act—and it was known that the gas was destined for interstate commerce. As to leases of reserves from landowners to lessee-producers there is no knowledge when the lease is executed of the ultimate destination of any gas that might be discovered,[15] no knowledge whether the gas, if discovered, will be sold either to an interstate pipeline or to any other customer that will move it across state lines. While the lease by the landowner provides for a royalty in the event of the discovery and sale of gas, typically he has no control over any incident of such sale either as to the quantity to be sold, the price to be paid, the identity of the purchaser or whether it shall be sold in interstate or intrastate commerce. To refer to the royalty owner as engaging in the sale is to depart from the common understanding of the words used, industry parlance, economic equivalent, or any other foundation hitherto considered a source for discerning Congressional intention.

The Commission's approach was this, that when a landowner executes a "proceeds" or "value" lease "he has contracted to retain an economic interest in interstate sales by the producer," and "has joined the other interest owners in such sales and he has become a seller of natural gas."[16] But an economic interest in the proceeds of a sale, unaccompanied by authority to determine the incidents of the sale, does not make one a seller. The de-

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[15] **The producer is a natural gas company because of the interstate movement conducted either by him or by his customer, assuming he discovers gas and makes a sale in interstate commerce.**

[16] **R. 542, 42 FPC at 172.**

veloper of a shopping center does not become a seller of food because he leases to a supermarket on percentage rental terms. A patentee who licenses various manufacturers on a royalty percentage basis is not generally considered the seller of the articles. Nor does the lessor become a seller of an article merely because the article was produced on or from the land that he leased. An owner of farmland leased to a farming tenant does not become a seller of produce raised because his rent may be a fraction of the price received for the crops. An owner of a mine leased to an operator does not become a seller of the ore produced because the stipulated compensation for the lease is a fixed fraction of the price received for the ore produced.

If the statutory use of "seller" or "sale" of natural gas in interstate commerce is referable to the meaning of these words in ordinary usage, or as likely understood by Congress, the FPC's ruling is clearly unsound. We do not think a different result warranted or mandated on the ground that the purpose of the Act is to protect the ultimate beneficiaries against exploitation by natural gas companies. That was indeed the objective of Congress, see *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944). The FPC is to be commended for attempting to further that objective, but it is not sufficient justification upon which to base an expansion of the Act to activities clearly not within its terms. Congress did not give the FPC carte blanche to take whatever action it might consider appropriate in furtherance of this purpose. The FPC is limited by the provision establishing its jurisdiction, and we do not find in that provision, rooted as it is in a sale in interstate commerce, any basis for reaching out to cover the landowner's lease or its royalty payments. We think it too far removed from the interstate sale. When there is a sale of gas to a pipeline in interstate commerce, the FPC will of course have the jurisdiction

and the responsibility to exercise control in the interest of the ultimate consumer.

We turn to a consideration of what may be implied as to jurisdiction from the requirement of effective Federal regulation of producers and pipelines. Of course for leases executed after this controversy took shape, it seems probable that producers will be able, and indeed have been able, to insist on leases drafted so as to avoid recurrence of the present controversies.

More significantly, the FPC's jurisdiction over rates chargeable by a producer includes authority to determine the reasonableness of costs incurred, even though these are not subject to direct FPC control, and that establishes authority to review royalty payments, or drilling rig rentals, or any other element of the producer's cost of service.[17] *Permian Basin Area Rate Cases*, 390 U.S. 747, passim and at pp. 824-25 (1968). And we interject that this is the only approach that even the FPC has in mind for handling other elements of the total payments made by producers to landowners, *e.g.*, the cash bonus, delay rentals.

Intervenor Shell Oil Co. put forward the contention that jurisdiction should rest on the burden created on interstate commerce by allowing royalty payments in excess of producers' rates. The Commission opinion stated that "since we find that an actual sale for resale by an interest owner does take place under the royalty provisions of the mineral leases the argument of Shell and

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[17] In the Permian Basin area rate decision, eventually sustained by the Supreme Court, the FPC calculated the average cost of producers affected, as to royalty payments, on an assumption of 12½% of total cost of service (including return on capital). FPC opinion No. 468, 34 FPC 159, at 192 (1965).

Tenneco constitute an additional, but not the basic, reason for asserting jurisdiction." [18]

If an interpretative ruling stretching the Act as written to cover leases by landowners is to be countenanced on the score of necessity, and we do not say this will be possible, the underlying record must be more comprehensive and profound—broader and deeper, as it were—than the findings and analysis presented on this record. The case as it comes before us, with a cursory "makeweight" reference to a possible theory of economic burden, is in a wholly different posture from that presented in *United States v. Southwestern Cable Co.*, 392 U.S. 157 (1968), which held CATV systems to be within the Federal Communications Act's coverage of "all interstate and foreign communication by wire or radio", 47 U.S.C. § 152(a), and relied significantly on the FPC's finding that achievement of its regulatory purposes would be placed in jeopardy by the unregulated growth of CATV.

As to the problem of economic burden and higher prices for consumers although the record contains evidence and findings concerning different forms of industry contracts (see Appendix) we have no findings concerning the extent or significance of market price contracts. And the FPC's opinion gives no concrete indication of whether, in what circumstances, or to what extent, there may be an economically meaningful problem of "market prices" in excess of ceilings. In the *Huber* case the judgment entitling the royalty owners to pursue their claim made no determination of amounts of recovery. Apparently such litigation may come to involve substantial sums even if pursued so as to recover royalties based on ceilings higher than filed rates. This we infer from the fact that Mobil

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[18] 42 F.P.C. at 172, 173, R. 5043.

Oil and other producers have appealed from the ruling of the FPC that although the royalty owners' filing obligations are met by virtue of the filings made by the producers,[19] a royalty owner is not limited to the rate filed by the producer and may enforce his contract as calling for a higher rate if permitted by the Act.[20] The record simply does not focus on what may be involved in the possibility of recover" of royalty calculated on the basis of "market prices" hig'er than ceilings.

Questions have come to our mind concerning the FPC's theory as to how the royalty owners may be shoe-horned into the existing regulations, and we at least have it in mind that if the FPC's assertion of jurisdiction over royalty owners were sustained its regulatory problems might be more complicated than it has assumed.[21] To

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[19] The FPC stated (42 FPC at 173, R.5043) that by operation of the law the "jurisdictional royalty interest has in effect been covered by the producer filing since 1954, on the same theory as a producer's filing covers the interests of all non-signatory parties, and should continue to be so covered. Therefore the FPC concluded no amendment or extension of existing rules was needed.

[20] "Where he [the royalty owner] has contracted for the market price or value it would appear that he has contracted for a payment equal to the maximum rate for such gas which could have been received [by the producer] as fixed under the law by this Commission. . . . Where no just and reasonable rate has been fixed and the producer has agreed to pay the royalty interest owner more than he himself receives for the gas, we believe that the basis of the effective rate [the rate filed by the producer] subject to adjustment when the just and reasonable rate is determined." 42 FPC at 174.

[21] We are puzzled by the FPC conception that royalty owners are, and have since 1954 been, natural gas companies under the Act, limited under § 4 of the Act to their rates

avoid any misunderstanding we interject that we have not been made uneasy by the contentions the producers have presented to us,[22] for we see no theoretical impediment to producers' being held on the basis of a contract to a royalty payment related to a base higher than the producers' filed

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as filed, even though they have not made filings and indeed could not have made filings, and by the corollary conception that the royalty owners are deemed covered by the filings made by the producers yet may now sue the producers for a higher basis.

It is one thing to consider a nonsignatory represented by the signatory when they have a common interest. But as we see it the reason why the FPC is asserting jurisdiction over the royalty owner is to handle the situation of a controversy between royalty owner and producer, and we are at least uneasy with an analysis whereby the royalty owner makes his filing by incorporation within the producer's filing and yet is free to seek a higher basis. If the royalty owners should recover on a basis of a market value higher than the rate that was filed by producers, it is difficult to discern how they may be deemed in compliance with the obligation of natural gas companies, for any sale subject to the jurisdiction of the FPC, to charge only the rate that is set forth in a public schedule filed with the Commission. It seems clear that the provisions of the regulations do not fit lessors.

We are also uneasy with the FPC's assumption that there can be no controversy between the landowner and the producer if an area ceiling is established. As we understand it the royalty owner was not, and apparently could not have been, a party to the area rate proceeding. If this is correct, it is not easy to see on what basis he can be held concluded by what has been established in such a proceeding, whether on conventional findings, or following a settlement.

[22] They complain that they are made subject to immediate contingent liabilities to make retroactive royalty payments if the FPC authorizes area rates higher than those previously filed by the producers even though the producers are prohibited from retroactively adjusting their rates.

rate. *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956). The producers make no claim, even obliquely, that they face financial or other difficulties requiring relief from contractual obligations, see *Permian Basin Area Rate Cases, supra*, 390 U.S. at 822, and insofar as general equitable considerations are concerned we suppose the FPC may have had in mind that its area ceilings are predicated on an assumption of royalty costs at a conventional fraction of ceiling prices (see note 17, *supra*).

In any event we are not persuaded that the maintenance in either state or Federal courts of contract (lease) controversies between royalty owners and lessees will undercut the Federal regulatory system. The controversies hitherto delineated by the private parties have focused on the producers' assertion of the need of the royalty owners to abide by the producers' filings and receipts. The problem of relationship of market prices to producer ceilings presents different considerations.

Without purporting to rule on the matter in any way, we can certainly visualize the possibility that a court confronted with a contention of entitlement to a market price basis higher than the producer's ceiling would consider it to run counter to the intention of the parties, unless there is something to rebut the fair presumption that they contemplated interstate movement and market prices compatible therewith.[23] The court might also consider that this result would be in furtherance of the general principle against application of contracts so as to contravene public policy, whether or not the result would be in violation of supremacy clause doctrine prohibiting state rules or de-

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[23] Compare Permian Basin Area Rate Cases, *supra*, 390 U.S. at 792 et seq., upholding departure from field prices in the public interest on the ground, inter alia, that various significant increases in field prices were "symptomatic of the deficiencies of the market mechanism."

cisions that require a regulated company to take action inconsistent with Federal regulation, see *Northern Natural Gas Co.* v. *State Corp. Comm. of Kansas*, 372 U.S. 84 (1963).[24]

The court handling the contract clause could avoid becoming embroiled in the ascertainment of the Federal ceiling by referring that issue to the FPC, invoking the broad and supple doctrine of primary jurisdiction, see *J. M. Huber Corp.* v. *Denman, supra*, 367 F.2d at 111; *cf. Brawner Building Inc.* v. *Shehyn*, —— U.S. App.D.C. ——, 442 F.2d 847 (1971).[25] This would bring the FPC into the dispute between the royalty owner and the lessee-producer, but the FPC would be acting properly, on reference from the courts, rather than unduly stretching its jurisdiction and the statutory mandate to extend to royalty owners.

Special Circumstances of Denman "R" Lease

While Commissioners Carver and O'Connor wrote strong dissenting opinions from the assertion of jurisdiction over the royalty interest in most gas leases, they agreed with the majority that variations in the Denman "R" lease rendered its royalties jurisdictional. Commissioner Carver found that the circumstances show "the lessor clearly identified his interests with those of the lessee-producer.

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[24] The question would arise whether a decision requiring a producer to pay the royalty owner on a basis higher than his Federal ceiling would be interfering with his carrying on interstate commerce conformably with the conduct prescribed for the producer by the Federal regulatory agency.

The question might be obviated in a particular case if the court discerned an intrastate market, capable of absorbing the volumes involved, not subject to any Federal ceiling.

[25] The producer could file for a declaration of ceiling, with notice to the royalty owner as party affected.

The privity found lacking in the usual and normal leasing arrangement is supplied under this particular facts."[26] We do not consider this matter, as we do not know whether a majority of the FPC would have taken the same approach initially, or would wish to do so in the wake of our decision.[27]

Reversed.

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[26] R. 5057, 42 F.P.C. at 183.

[27] Braniff Airways, Inc. v. CAB, 126 U.S.App.D.C. 399, 379 F.2d 453 (1967).

APPENDIX

Excerpts from Opinion of Presiding Examiner, see 42 FPC at 190, 191:

> Every provision in a lease is open to negotiation, but not every provision is actually negotiated in every transaction. The most common items of negotiation between the lessor and prospective lessee are the amount of cash bonus, the amount of delay rental, the length of the primary term, and the royalty fraction.
>
> The cash bonus is the cash consideration paid by the lessee to the lessor for granting the mineral lease and may range from a minimal amount to a substantial sum.
>
> The delayed rental is a payment for the privilege of deferring the commencement of drilling operations or the commencement of production.
>
> The primary term is the term of the lease during which the lease may be continued in effect without drilling operations or production by the payment of a delayed rental.
>
> * * *
>
> The landowner may create by grant or by reservation various estates in land. The interest we are concerned with here is called royalty and is created by a reservation in an oil and gas lease in which the landowner grants to the lessee certain rights and privileges, such as, to explore, drill and produce oil and gas, and in the same instrument reserves to himself, free from the expenses of production, a share in the oil and gas produced or the proceeds thereof. Williams and Meyers, *Oil and Gas Law*, Manual of Terms, 342; Volume 1, sec. 202, 202.1, 202.3. This share is usually expressed in terms of a fraction of the production. The fraction is generally one-eighth and in some instances a larger amount. The royalty interest as to oil produced is usually taken in kind, but as to gas produced, while the right to take in kind may be reserved, it is seldom done as a practical matter due to its characteristics and the lack of market other than the pipeline to which the lessee delivers the gas.

> The common provisions in the leases for accounting to the lessor for royalty as to the gas produced provide for the lessee to pay the lessor for his fractional part the market value in the field or a percentage of the proceeds derived from the sale of the gas.

In addition to the lessor's royalty interest, there is also another type of royalty interest called an overriding royalty interest. Such interest is most commonly created when a lessee enters into a farm-out agreement with another producer. In such an agreement the lessee retains either an undivided interest in the leases or an override interest. Both the lessor royalty interest and the overriding royalty interest as a contractual matter receive their respective interests free of any of the costs of production, except for taxes. The working interest owners generally share the expenses of development and operation of the property, proportionate to their interest in the property. Although the overriding royalty interest owner is a bare holder of a right to receive proceeds, the lessor royalty interest owner is protected by certain implied covenants with respect to the development of a lease and the marketing of the product.

* * *

In Docket No. RI67-113, there are involved three leases as to mineral rights in Texas, designated as the "R Lease" entered into on June 2, 1936, the "B Lease" and the "M Lease" on January 22, 1926. The royalty provision insofar as necessary for consideration here, under the "R Lease" which accounts for 93 percent of the production of gas provides for Huber, the leasee:

> To pay the Lessors monthly for one-fourth (¼) of the gas produced at the mouth of the well from any gas well, where gas only is found, four cents per one thousand cubic feet for the first ten years of this contract, and thereafter, the market price of such gas but in no event shall the price be computed at less than four cents per one thousand cubic feet.

Under the B and M Leases the royalty clause provides:

> ,o pay the Lessor the equal one-eights part of the market value in the field for the gas from each well where gas only in found, while the same is being used off the premises, * * *

The type of lease varies as to mineral rights in Kansas under Docket Nos. RI67-114, RI67-310 and RI67-400. The royalty clauses in the leases here necessary for consideration generally provide for the lessee to pay the lessor on gas marketed from each well where gas only is found one-eighth of the proceeds if sold at the well, or if marketed by the lessee off the premises, then one-eighth of its market value at the well. Some of the leases set forth only a proceeds type royalty clause and others only a market type royalty clause. Regardless of the type of royalty clause set forth in the leases involved in these proceedings, the landowners claim entitlement at the market price.

MacKinnon, *Circuit Judge*, concurring: I agree with the result and with the opinion insofar as it decides issues in this case. However, with respect to future cases that might involve the relationship of market prices to producer ceilings, I see no necessity to discuss the effect of the intent of the parties, public policy, federal supremacy, or the use of primary jurisdiction.[1]

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[1] *See* majority opinion, pp. 21-23, inclusive.

APPENDIX D

Federal Power Commission Opinion No. 562, Opinion and Order Determining Jurisdiction, Docket No. RI67-113, *et al.*, July 23, 1969

Presiding Examiner's Initial Decision on Jurisdiction Over Royalty Owners, Docket No. RI67-113, *et al.*, July 23, 1968

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Docket No. RI67-113

WILLIAM HARVEY DENMAN, Trustee, *et al.*

v.

J. M. HUBER CORPORATION

Docket No. RI67-114

MOBIL OIL CORPORATION

v.

CARL F. MATZEN, *et al.*

Docket No. RI67-310

WESTERN NATURAL GAS COMPANY

v.

ELMER HENNIGH, *et al.*

Docket No. RI67-400

PAN AMERICAN PETROLEUM CORPORATION

v.

LELAND C. WAECHTER, *et al.*

OPINION NO. 562

OPINION AND ORDER DETERMINING JURISDICTION

Issued: July 23, 1969

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Docket No. RI67-113

WILLIAM HARVEY DENMAN, Trustee, *et al.*

v.

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ELMER HENNIGH, *et al.*

Docket No. RI67-400

PAN AMERICAN PETROLEUM CORPORATION

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LELAND C. WAECHTER, *et al.*

OPINION NO. 562

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L. Dan Jones and *William I. Powell* for Independent Petroleum Association of America

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[5033]

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J. Harry Mulhern, Edward S. Kirby and *James R. Lacey* for Public Service Electric and Gas Company

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Samuel Gràff Miller and *Donald Blanken* for Philadelphia Electric Company

John Davenport for Texas Independent Producers & Royalty Owners Association

Francis J. Gilmore and *John W. Williams* for the Staff of the Federal Power Commission

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

JURISDICTION (Royalty Owners)

Before Commissioners: Lee C. White, Chairman; L. J. O'Connor, Jr., Carl E. Bagge, John A. Carver, Jr., and Albert B. Brooke, Jr.

Docket Nos. RI67-113, *et al.*

WILLIAM HARVEY DENMAN, Trustee, *et al.*

v.

J. M. HUBER CORPORATION, *et al.*

OPINION NO. 562

OPINION AND ORDER DETERMINING JURISDICTION

(Issued July 23, 1969)

WHITE, Chairman:

INTRODUCTION

This proceeding arose following a decision of the United States Court of Appeals for the Fifth Circuit in *J. M. Huber Corp.* v. *William Harvey Denman, Trustee, et al.*, 367 F. 2d 104 (1966). That case involved a claim by Denman as a royalty holder that under the terms of his lease with Huber he was entitled to a royalty payment based on up to one-fourth of a market value of 23 cents per Mcf for gas sold by Huber in interstate commerce at prices ranging between 4 cents and 11

cents. The District Court found in favor of the royalty owner and on appeal the Circuit Court agreed that the royalty owner was entitled to the market price under the terms of his contract. However, the Circuit Court also found a serious question as to whether any court may allow increased royalty payments without express FPC approval if the result is to fix royalties on the basis of market prices in excess of the price the lessee-producer was authorized to charge pursuant to valid FPC regulation. The Court concluded that the FPC should make an initial determination of its jurisdiction over royalty payments. In referring the issue to the Commission the Court requested a ruling by the FPC:

> "(a) as to the jurisdiction of the FPC over payment for royalties for gas sold for resale and transport in interstate commerce, (b) the status of a royalty interest owner's transaction as a *sale* under the Act where incident to a sale for resale and transportation in interstate commerce, (c) the status of the royalty interest owner's transaction in this case as a *sale* under the Act."

Thereafter, Denman petitioned the Commission for an order disclaiming jurisdiction over the amount of royalties payable under the terms of the oil and gas leases involved. Mobil Oil Corp., Western Natural Gas Co. and Pan American Petroleum Corp. also filed complaints requesting a Commission determination that certain royalty payments arising out of some of their jurisdictional sales were jurisdictional. The Commission consolidated these complaints and in setting a hearing limited the issues in the following terms:

"The hearing in these cases shall be confined to resolving whether the Commission has jurisdiction over a landowner's royalty interest in natural gas leaseholds and, if answered in the affirmative, how such jurisdiction should be implemented. More specifically the parties should address themselves to the method which should be used in computing gas royalty payments and what additional filing requirements, if any, should be imposed and upon whom." (Footnote omitted)

A number of interventions were filed with the producers and distributors generally supporting a finding of jurisdiction and royalty owners and their associations generally opposing jurisdiction.

EXAMINER'S DECISION

Following a hearing, Examiner Alvin A. Kurtz held that the royalty owners are natural gas companies for purposes of the Act and payments to them are subject to the jurisdiction of the Commission. He further held that filings would be necessary by a royalty owner only when he asserted a higher price for his fractional share of the gas than that which the producer or lessee was authorized to collect. In reaching his conclusion, Examiner Kurtz held that removal of the royalty percentage of the gas from effective Commission regulation whenever the royalty contract is interpreted to base the landowners share of the revenues on a percentage of the unregulated field or market price would create a gap in that regulation which was not intended under the Act or the various court decisions. In this respect, he relied especially upon *Phillips* v. *Wisconsin*, 347 U.S. 672 (1954), *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965) and *California* v. *Lo Vaca Co.*, 379 U.S. 366 (1965).

He also noted that in 1957 and 1959 in two unreported cases,[1] the Commission, at the request of royalty owners, had issued certificates to them; also noting that Commissioner Digby protested these as making a landmark policy decision without sufficient consideration. He rejected the royalty owners' reliance on *F.P.C.* v. *Panhandle Eastern Pipeline Co.*, 337 U.S. 498 (1949) where it was held that the transfer of undeveloped leases was not subject to Commission jurisdiction. He noted that that case involved the transfer of leases where the gas was to be sold in intrastate commerce, where in these cases the gas is being sold interstate. He noted that by the terms of the lease, the royalty owner had a continuing interest in production and the flow of gas into interstate commerce. Noting that our basis for fixing area rates was based on cost computations including royalties, he found that there could be a substantial effect upon consumers if excessive royalties were collected, and thus concluded that it was necessary to assert jurisdiction to protect consumer interests as intended by the Act.

The Examiner, likening a royalty interest holder to that of any other interest owner, including nonsignatory working interests, noted that in *Sun Oil* v. *F.P.C.*, 256 F. 2d 233, cert. denied, 358 U.S. 872 (1958), it was held that regulations providing that nonsignatory parties, or those selling on a percentage basis, need not be permitted to file certificate applications or rate schedules in the absence of a waiver for good cause. On this basis, he further concluded that filings by royalty owners should be avoided as far as feasible and need only be made where the royalty owner intended to justify a higher price for a fractional share of the gas over that of the

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[1] Docket No. G-11462, June 3, 1957 and Docket No. G-10001, March 23, 1959.

lessee. He further concluded that any regulations necessary to this should be the subject of a general rulemaking applicable to all royalty owners.

[5038]

EXCEPTIONS

Exceptions to the examiner's decision were filed by the royalty owners named in complaints by the producers, by Denman, by the Old Ocean Royalty Owners Association and by the Land and Royalty Owners of Louisiana. Exceptions were also filed by the staff and a number of the producers.

In general, the producers' exceptions were directed only at the examiner's recommended procedures which would allow a royalty owner to file for a higher price for his percentage of the gas than the producers were getting for their percentages in circumstances where the producers' contracts rather than just and reasonable (or in-line) ceilings set by the Commission were the limiting factor. The producers in general believe that the royalty owner should be allowed no more for his percentage of the gas than the finally effective rate which the producer has on file. Humble, Marathon and Texaco excepted on the ground that the examiner made insufficient findings of fact and law and, therefore, they could not comment on the decision since he did not state his basis adequately.

Shell Oil Co. excepted to the examiner's finding that royalty owners were natural gas companies, contending that regulation of royalty payments was necessary only to the extent that payments based upon a market price higher than the regulated price could have an effect on the regulated price of gas moving in interstate commerce.[2] Shell concluded that the burden on interstate commerce which might

[2] This was also the position taken by Tenneco Co. before the presiding examiner.

result was sufficient basis for the Commission's exercise of jurisdiction to hold all royalty owners to the contract specified percentage of Commission-approved prices and that it was unnecessary to this end to find that the royalty owners were natural gas companies making sales of gas for resale in interstate commerce. In reaching this conclusion, Shell relied to a large extent on *Northern Natural Gas Co.* v. *State Corporation Commission of Kansas*, 372 U.S. 84 (1963).

Staff exceptions were limited to the examiner's implementation procedure. Staff took the position that no filings by royalty owners should be required, but that a royalty owner, if contractually entitled thereto, should be allowed to obtain a Commission-fixed area rate, whether or not the producer was receiving that high a rate. This situation would arise primarily where the producer had settled at a rate below the area rate ultimately determined. In addition, staff would provide that the royalty owner could, if contractually entitled, collect this rate all the way back to 1954.

The various royalty owners and associations object both to the finding of jurisdiction and the limited implementation of jurisdiction if upheld. In general, the royalty owners argue that a mineral lease is a simple transaction in real estate and not in any way a sale in interstate commerce by the landowner. They argue that the royalty payment is only a small part of the lease which is in fact only a rental of the land for various considerations. They argue that the lease creates only a contractual relation of lessor and lessee between the royalty owner and the producer and that such contracts have always been governed by state law.

The royalty owners further note that they were in no way a party to the sale of the gas by the lessor to a pipeline purchaser, nor have they ever been included in settlement proceedings before the Commission. They further state that there should be no effect on consumers from the payment of royalties since this is done by the producer within the area rate and is not passed on to the pipeline purchaser. They suggest that worrying about the royalty payment as an included cost in area rates is no different than worrying about the cost of steel pipe, bonus payments, delay rentals, labor costs, etc. They contend that the FPC in asserting jurisdiction would not be regulating the price of gas but rather the cost of production.

In reply to these arguments the staff, producers, distributors, and the State of California point out that the mineral lease requires that the producer sell the gas as best he can and that in fact the royalty-payment provision of the lease is not operative until the gas is actually sold. They argue that what the royalty owner gave in a mineral lease was a sale of gas, or other minerals, in place for a certain consideration and that the lease was a necessary part of the whole sale transaction which results in the flow of gas through interstate commerce. They further argue that what the royalty owner does is retain a fractional interest in all production pointing out that he gets a depletion allowance just like any other interest owner. In this connection, the producers also argue that just like any other interest owner the royalty interest should be covered by the filing of the operator of the lease and there is no need for any filings by royalty owners.

CONCLUSION

Based on the evidence in this proceeding, the parties' briefs, the examiner's decision, the exceptions and replies

and the oral argument before us, we conclude that the Commission does have jurisdiction over the royalty owners' interest in natural gas sold for resale in interstate commerce and that such jurisdiction can be implemented without undue additional administrative burdens upon the parties or this Commission.

[5041]

DISCUSSION

The basic fact here is the effective retention by the royalty holders of a percentage interest in the gas sold in interstate commerce. While that portion of the royalty contract on which the royalty owners focus, which results in payments prior to the production or discovery of natural gas or payments unconnected with the production of gas, may well be nonjurisdictional under the decision in *Panhandle Eastern Pipeline Co.* v. *Public Service Comm.*, 337 U.S. 498 (1948), the remaining portion of the arrangement, which results in payment to the royalty holder based on the production of natural gas for sale in interstate commerce, seems to us plainly to be jurisdictional. This distinction between persons providing goods or services for a production operation for a percentage of the receipts of subsequent gas sales and those receiving, instead, fixed fees is not novel. Thus if a producer needs $30,000 to pay expenses for his exploratory and development activities and secures $10,000 each from A, B and C, with A taking a note for repayment of the loan with interest, B taking a 10 percent interest in the gas sale proceeds and C taking a note for $5,000 and a 5 percent interest in gas proceeds for the other $5,000, it is clear that B will technically be a natural gas company (though probably a nonsignatory, nonoperator party not eligible under the Commission's Rules to file a separate rate schedule or secure a separate cer-

tificate) and C will be also, though not with respect to the $5,000 on which it merely took a note.

In viewing the overall problem here presented it would be senseless to attempt to determine what is a natural gas company and what is a sale on the basis of Hornbook definitions or local decisions not applicable to the Natural Gas Act. The question of whether royalty payments are subject to our jurisdiction must be examined with the terms of the Natural Gas Act in mind together with the intent of Congress, in the passage of that Act, to assure an adequate supply at the lowest reasonable rates. For purposes of the Act, a "natural gas company" is a person engaged in "the sale in interstate commerce of [natural] gas for resale" but whether his operations would be classified as a "sale" under private law is not determinative, *UGI* v. *Continental Oil Co.*, 381 U.S. 392. The issue here is whether a person receiving payment

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for a percentage of each or any Mcf of natural gas sold for resale in interstate commerce is in fact engaged in a sale of such gas for purposes of the Natural Gas Act. We conclude that if he has contracted to retain an economic interest in interstate sales, he has joined the other interest owners in such sales and he has become a seller of natural gas and therefore a natural gas company.

While the royalty owners in this proceeding have emphasized the various provisions contained in the mineral leases covering such things as bonus payments, delay rentals, and shut-in royalties, the only provisions in any of the leases which are relevant to this proceeding are those which provide for payments after gas is actually being produced and marketed. There are various provisions in these leases providing for such royalty payments based on "proceeds," "market value," "market price," "wellhead value," etc. These provisions may provide for

the payment of a percentage of one of the above or provide that one of the above will be paid for a fraction of the gas. Regardless of which of the provisions is in the lease the payment is based on the production and sale of the gas. Thus it is clear that the royalty payments represent an interest in the sale of the gas and represent payment to the royalty owner for this interest in the sale.

Some of the parties who agree that a sale of gas by a royalty owner does take place have suggested that the sale is an in-place sale of all the gas to the producer, the compensation therefor being a percentage of the proceeds of any resale. The question of whether the sale is in-place to the producer who then sells the gas or the direct sale of a fractional interest to an interstate pipeline would seem to be irrelevant for jurisdictional purposes in light of the decision of the Supreme Court in *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965). See also *Deep South Oil Co.* v. *FPC*, 247 F.2d 882 (CA5, 1955). In either event it is subject to our jurisdiction.

The same applies to the argument made by Shell Oil Co. and Tenneco Oil Co. that jurisdiction should rest on the burden created on interstate commerce by allowing royalty payments in excess of producers' rates. If in fact there were no sale for resale involved, then jurisdiction might well be found under the holdings in the cases of *Northern Natural Gas Co.* v. *State Corporation Commission of Kansas*,

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372 U.S. 84 (1963) and *U.S.* v. *Southwestern Cable Co.*, 392 U.S. 157 (1968). However, since we find that an actual sale for resale by an interest owner does take place under the royalty provisions of the mineral leases the argument of Shell and Tenneco constitute an addi-

tional, but not the basic, reason for asserting jurisdiction.

The argument against now asserting jurisdiction over royalty interests based on our failure to assert it since 1954, aside from its basic lack of merit (see *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672) also lacks a partial foundation. As indicated, *supra*, in the only two instances where the matter has previously been before us we asserted jurisdiction. While we do not suggest that these brief orders are decisive of the legal question, we point out that prior to the recent decisions interpreting market value provisions of royalty contracts to afford royalty owners a fixed percentage of a higher unregulated price, there was no more reason to assert special jurisdiction over royalty interest holders than over th producers making percentage sales to other producers or plants. Our rules for producer filings since 1954 have provided that the filing by the producer shall cover the interests of all nonsignatory parties or those selling on a percentage basis. Our rules further provide that nonsignatory co-owners or percentage sellers may not file on their own behalf in the absence of a waiver of our rules as necessary to protect their separate interests. This method of regulation was specifically upheld in *Sun Oil Co.* v. *F.P.C.*, 256 F.2d 233, *cert. denied*, 358 U.S. 872 (1958).

The jurisdictional royalty interest has in effect been covered by the producer filing since 1954 and we see no reason why it should not continue to be covered by the producer filing. As the evidence in this case indicates, until these proceedings were instigated, the general practice was for the producer to settle with the royalty interest on the basis of his filed rate. We assume that this will continue to be the practice in almost all situations and, therefore, no provision beyond our existing rules ordinarily will be necessary to cover regulation of royalty interests.

We do, however, recognize that for the first time these proceedings represent an argument by an interest owner that his reimbursement from the producer is not in accord with his contract. While we find that the royalty owner has authorized

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the producer to sell his interest, we do not believe the royalty owner must be held to the producer's filed rate if his contract with the producer calls for royalties based upon a different rate which the producer could have secured under Commission regulation had he contracted for it. As is any interest owner, the royalty owner is free to write his own contract subject only to the limitations of the Natural Gas Act. Thus the royalty owner is limited in the price upon which his royalty interest is to be based only by the limits of the Natural Gas Act. Where he has contracted for the market price or value it would appear that he has contracted for a payment equal to the maximum rate for such gas which could have been received as fixed under the law by this Commission. Since he is selling gas in interstate commerce, his rates are subject to Commission approval and he cannot under the Act receive a price in excess of the just and reasonable rate, whatever the provisions of his contract. Thus a producer who has agreed to pay the royalty interest owner something more than he himself receives for the gas could be required to pay the just and reasonable rate as fixed by the Commission. Where no just and reasonable rate has been fixed and the producer has agreed to pay the royalty interest owner more than he himself receives for the gas, we believe that the parties will be required to settle on the basis of the effective rate subject to adjustment when the just and reasonable rate is determined. With this guidance we see no reason why the producer and royalty owner cannot settle between

them without additional filings by the royalty interest owner or the producer.

Inasmuch as we have asserted jurisdiction over producer rates only since June 7, 1954, the principles enunciated herein will apply only to gas which has flowed since that date. For gas which flowed prior to June 7, 1954, the parties will be left to their contractual remedies, to the extent otherwise viable. These disputes are, of course, matters which are for resolution by a court of competent jurisdiction.

The Commission further finds:

(1) The royalty payment provisions of oil and gas leases constitute a sale for resale of natural gas in interstate commerce subject to regulation under the Natural Gas Act and the royalty owners are natural gas companies for purposes of the Act.

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(2) The interests of the royalty owners are covered by the filings of the producer-operators and no additional filings with this Commission are required.

The Commission orders:

(A) Based on the above opinion and findings, it is hereby declared that the royalty provisions of oil and gas leases constitute sales of natural gas for resale in interstate commerce subject to all of the provisions of the Natural Gas Act.

(B) For regulatory purposes such sales are covered by the filings of the producer-operators and payment by the producers to the royalty owners should be made as provided by the contractual provisions of each lease, except that in no event should the payment exceed the just

and reasonable rates as fixed by the Commission under the Act.

By the Commission.

Commissioner Carver dissenting in part and concurring in part filed a separate statement appended hereto. Commissioner O'Connor dissenting in part and concurring in part filed a separate statement appended hereto.

(SEAL)

KENNETH F. PLUMB,
Acting Secretary.

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Docket No. RI67-113

WILLIAM HARVEY DENMAN, Trustee, *et al.*

v.

J. M. HUBER CORPORATION

Docket No. RI67-114

MOBIL OIL CORPORATION

v.

CARL F. MATZEN, *et al.*

Docket No. RI67-310

WESTERN NATURAL GAS COMPANY

v.

ELMER HENNIGH, *et al.*

Docket No. RI67-400

PAN AMERICAN PETROLEUM CORP.

v.

LELAND C. WAECHTER, *et al.*

(Issued July 23, 1969)

CARVER, Commissioner, *dissenting* in part and *concurring* in part:

This matter comes before this Commission in the form of petitions for declaratory orders and complaints in opposition thereto, all designed to secure a determination as to the jurisdiction of the Commission to regulate royalty payments under oil and gas leases. Many of those

leases pre-date the enactment of the Natural Gas Act; at least one of the leases involved in *Denman* (Docket No. RI67-113) has been in effect since 1926.

We may (indeed we must, if the true significance of the proceeding is to be recognized) take official notice of the fact that the real moving force in the matter is a judicial decision in a proceeding to which the Commission was not a party, as described in the majority opinion. *J. M. Huber Corp.* v. *William Harvey Denman, et al.* (1966) 367 F.2d 104. Our reply to questions raised by the United States Court of Appeals for the Fifth Circuit can be indirect at best, however, since its directive was to the parties before it; there has been no direct referral or certification of any question to this Commission by the Court. Our decision must, therefore, be responsive to the issues as they have been presented to us by the parties.

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In this connection, I feel compelled to express misgivings as to whether the procedure involved here represents a proper and acceptable application of the doctrine of primary jurisdiction. The careful, learned and extensive opinion of the Fifth Circuit goes to some length in demonstrating that "there is really nothing startling about submitting to an agency for initial decision the question of its own jurisdiction." With all due respect, the precedents cited seem not to support that conclusion as applied here.

In none of the cases referred to by the Court was a regulatory or administrative agency called upon to exercise the full, free and initial scope of its discretion in defining its own jurisdiction. The cases involved fall into two categories: (1) those where the Court itself found, as a matter of law, that the matter in issue was clearly within agency jurisdiction and, as a result, was not ready for judicial determination, *Southwestern Sugar and Mo-*

lasses Co. v. *River Terminals Corp.* (1959) 360 U.S. 411, *U. S.* v. *Western Pacific R. R.* (1956), 352 U.S. 59, *Far East Conference* v. *U. S.* (1952), *Carter* v. *A.T.T.* (1966) 365 F.2d 486; and (2) those in which the agency had already asserted its jurisdiction and taken steps to implement it, but was unable to take final action because of an appeal from or collateral attack upon its jurisdictional finding. *Marine Engineers Beneficial Association* v. *Interlake Steamship Co.* (1962) 370 U.S. 173, *Myers* v. *Bethlehem Shipbuilding Corp.* (1938) 303 U.S. 41, *Arkansas Power and Light Co.* v. *F.P.C.* (1945) 60 Fed. Supp. 907 (ultimately affirmed, *per curiam* (1947) 330 U.S. 802).

As the Court has recognized, however, the procedure it has adopted represents a novel *application* of the primary jurisdiction doctrine. This is by no means to say that it is an erroneous or improper one; indeed the philosophy of judicial-administrative comity evidenced therein is constructive and deserving of increased usage. My concern arises from the narrow terms of reference within which the Commission is asked to make its decision. Since this point involves questions of the independence of the regulatory function, I believe the matter should be exposed to discussion, even though there may be no clear basis for resolution in this proceeding.

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In the District Court phase of the *Denman* case, four questions were stipulated for decision, three involving substantive questions of lease or contract interpretation and the other having to do with FPC jurisdiction. All were decided by the District Court. The three substantive issues were affirmed by the Circuit Court, to the effect that royalty provisions expressed in "market price" terms meant that prices in excess of regulated rates fixed by this Commission should be used in royalty computations.

In effect, therefore, we are on notice that unless we subject royalty rates to our control under the Natural Gas Act and, through interpretation of that Act, restrict royalty rates to a percentage of the regulated price, we must anticipate pressures to increase the rates authorized for interstate sales of natural gas. By this device, a strong incentive for a jurisdictional finding has been established by judicial predetermination.[1]

The Circuit Court then proceeded to its own analysis as to how the Commission might implement its jurisdiction if it were found to exist. In so doing, the Court tended to minimize excessive administrative requirements, thereby adding to the prejudice in favor of a jurisdictional finding. Through that process, moreover, the Court has exerted heavy influence on decisions tht are allocated to the regulatory discretion of this Commission. In the face of its advice we are hardly free agents as to the best ways to implement jurisdiction, if found.

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Finally, although the Court refrained from addressing any directive to this agency, it specified in precise terms what jurisdictional issues the parties should present for our decision. In the context of the case then pending be-

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[1] This observation is made in full recognition of the dilemma which confronted the Fifth Circuit. In Southwestern Sugar and Molasses Co. v. River Terminals Corp., *supra*, that Court was partially reversed for failure to resolve substantive questions of law before remanding the case for ICC determination. On the other hand, a long line of cases has established the rule that "courts ordinarily should not interfere with an agency until it has completed its action, or else has clearly exceeded its jurisdiction," reiterated as recently as the last term in McKart v. U. S. (1969) —— U.S. ——, 89 S.Ct. 1657. The sharp factual differences between this case and Southwestern Sugar are important; in the latter, the substantive questions of law were determinative of the case and in fact, eliminated any need for ICC consideration, which was the real reason for remand.

fore the Court, some or several of those issues were and are not ripe for decision and the proper parties may not have been before this Commission to compile a proper record for decision. Despite the extent and specificity of the judicial pronouncement, therefore, our decision must be limited to the matters presented to us.

Notwithstanding the straight-jacket implications of the terms under which the matter reaches us, the fact is that numerous parties have petitioned us for a jurisdictional determination. While I feel that the original litigants should have sought further judicial recourse from the Circuit Court's decision for the reasons outlined above, I agree that we have no alternative but to decide the issues to the extent that they are now before us by legitimate process.

The question we are called upon to decide is twofold: (1) whether, as a general proposition and under the relationships normally and usually created by standard oil and gas leases, this Commission has jurisdiction to control the amounts received by royalty interest holders for gas production, and (2) whether the specific leases under scrutiny in these proceedings conform to the general concept such as to bring them under the conclusion reached in (1) above. The majority reaches an affirmative conclusion on the initial issue and on such a broad basis that the same result automatically follows as to the subsidiary question.

I reach an opposite result on the main issue and therefore must express a general dissent. On the other hand, at least as to one of the leases in one of the cases before us (the R-Lease in Docket No. RI67-113) there is a factual abberation which requires a different conclusion. As to that particular transaction, I concur in the result reached by the majority, but for wholly different reasons as set forth below.

The Presiding Examiner's Initial Decision identifies the central issue with accuracy and precision: ". . . the

issue as to the Commission's jurisdiction must be determined under the provisions of the Natural Gas Act." (Mimeo. at p. 12). In the whole complex history of jurisdictional litigation, the one visible point of reference is that our authority and our responsibilities are statutory in origin; for us, jurisdiction is an inescapable function of statutory construction.

My basic disagreement with the Examiner's decision and the sustaining view of the majority opinion is that the test so clearly defined in the initial decision has not been met. With only the most general reference to statutory criteria and in reliance on precedents that have no direct bearing on the present issues, all royalty owners under conventional leasing agreements are declared to be "natural gas companies" engaged in the "sale in interstate commerce of natural gas for resale," whether they happen to be experienced exploration investors or plain dirt farmers willing to facilitate a wildcat venture. For me, such a bootstrap conclusion taxes credulity to the breaking point.

The majority opinion goes beyond the limits of statutory definition in seeking a jurisdictional peg. At least on a "make weight" basis, it adopts the intriguing theory advanced by certain intervenors (principally Shell and Tenneco) to the effect that the Commission has an ancillary duty, or is faced with a compelling necessity in aid of its comprehensive function, to abate a burden on interstate commerce. In my judgment this view is untenable and must be resisted, even though it is not central to the present opinion.

The Concept of a "Sale" of Natural Gas

In the search for a statutory mooring that will sustain an exercise of jurisdiction, the majority opinion re-

lies on three basic premises: (1) that there has been a "sale in interstate commerce of natural gas for resale" to which royalty owners have been parties in sufficient degree to make them subject to the Act, (2) that this "has been so all along" under the terms of our regulations and prior actions on certificate applications, and (3) that failure to so hold would conflict with judicial expressions of general philosophy that the Natural Gas Act has an overriding purpose to provide a comprehensive scheme of regulation which can tolerate no gaps or evasions.

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Quite obviously, if the first two enumerated elements, or either of them, is satisfied with certainty, there is no need to construct a complex fabric of generalizations to reach beyond the express terms of the statute. This lack of confidence in the specific premises is so fully justified that I cannot accept the final basis of decision as supplying the deficiencies of the others.

In order to support a finding that royalty owners have participated in a sale of natural gas, it is essential that some specific operative act, some definite transaction, be identified as having the legally accepted characteristics of a "sale." Except for a brief colloquy in oral argument before the Commission (Tr., p. 935), that kind of analysis does not appear in the record of this proceeding. Does the sale occur as a necessary incident of the original lease transaction? Or is it to be inferred from the separate, usually subsequent, contract by which the lessee-producer commits his production to an interstate pipeline purchaser?

We don't know the majority's theory in this respect, because the issue, and indeed the whole matter of how a sale occurs, is evaded by a forensic *tour de force*. The fact of a sale is declared, rather than demonstrated by any acceptable rationale. And we are told that technical

concepts of law have no bearing since this Commission is not bound "by Hornbook definitions or local decisions not applicable to the Natural Gas Act." There is little doubt that this is an accepted benchmark in rule case law; both as a general proposition in the construction of Federal statutes, *Prudence Realization Corp.* v. *Geist* (1942) 316 U.S. 82, and as specifically applied to the Natural Gas Act, at least in the context of *Rayne Field, United Gas Improvement Co.* v. *Continental Oil Co.* (1965) 381 U.S. 392.

But we are not at liberty to enlarge that principle into an unrestricted license to snatch our own definitions out of the cosmos, hand-tailored to fit the case, any more than problems of construction can be swept away by denigrating reference to established legal concepts. The precise task at hand is to give meaning and effect to the "sale for resale" criterion of jurisdiction and to measure the concept of a mineral lease against that standard.

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Absent some clear indication that Congress meant to abandon and deny accepted principles of property and contract law, they should be used as interpretive guideposts and aids to construction.

Notwithstanding the limited effect historically given to the Rule of Decision Act, now revised and codified at 28 U.S.C. 1652, and the systematic erosion that has occurred into the *Erie* v. *Tompkins* doctrine,[2] there is still a strong policy predilection toward reliance on State law "to give meaning and content to federal statutes" especially in matters relating to the acquisition, transmission and transfer of property. *Davies Warehouse Co.* v. *Bowles* (1943) 321 U.S. 144, 145.

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[2] See Friendly, "In Praise of *Erie* and of the New Federal Common Law," (1964) 39 N.Y.U. Law Review 383; unsigned Note, "The Federal Common Law (1969) 82 Harvard L. R. 1512.

Unfortunately, even reference to State court decisions may not be particularly helpful in a positive way in this instance. As the Fifth Circuit has pointed out, even the standard treatises on oil and gas law have extreme difficulty in reconciling the great variety of holdings on the essential nature of mineral leases and the interests created thereunder. Thus a gas lease may be regarded as conveying an interest in real property, or creating a determinable fee in the gas in place, or granting a *profit à pendre*, or a corporeal or incorporeal hereditament, and the legal and economic interests thus created may be equally lacking in uniformity—all depending on local law.

What seems most important for our purposes here is what the State decisions have *not* held. Viewed in this perspective, one basic point of unanimity survives: *in no State has it been found that a primary lease constitutes a sale of gas as a commodity separate and apart from its association with the realty.* Thus, the fact we may not be *required* to apply local law in each instance provides little justification for adoption of a rule that would be contrary to the prevailing law in *all* jurisdictions, however the local rules may vary.

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If it is intended that the case rest on the alternative theory that the "sale" occurs at the point of commitment to the interstate market, that view founders on an elemental point of contract law. To be binding on the royalty owner, he must be construed to be a party to the producer-pipeline purchaser agreement. But this requires a showing of privity and a party is not considered privy to a sales transaction unless he has had some voice, some indication of positive acquiescence in its terms. Effective control, at least in proportion to legal interest, over the offer or the acceptance is essential to participation in the contract.

With the exception of one of the contract documents involved in Docket No. RI67-113, which is discussed under a separate heading below, there is nothing in this record to demonstrate, or even suggest, that royalty owners participate in any way in producer decisions on product marketing. That is solely a function of the working interest, as that term is fully and accurately set forth in the Examiner's opinion (and see below). Once a lease has been executed, absent a specific and atypical provision to the contrary therein, the royalty interest is a wholly passive factor in the subsequent enterprise.

To say, as the majority opinion does, that "he [royalty owner] is selling gas in interstate commerce" is simply not supported by the record or by the relationships that have developed in this important industry. If he had any effective voice in marketing decisions, the royalty owner would always opt for the highest price (and therefore the highest royalty income) regardless of the producer-lessee's commitments to the interstate regulated market. That he cannot control this decision is ample evidence that he is not a party to the sales transaction.

The majority opinion places principal reliance for finding a sale on *Rayne Field (UGI* v. *Continental Oil Co., supra)* and the cases which have followed it. *Pan American Oil Co.* v. *F.P.C.* (1964) 339 F.2d 694 (Bastian Bay); *Continental Oil Co.* v. *F.P.C.* (1966) 370 F.2d 57, *cert. den.* 388 U.S. 910 (Ship Shoal area). It is now familiar that these cases establish jurisdiction over the *transfer of leasehold interests in proven and developed fields for eventual resale in interstate commerce.*

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The three elements emphasized above make *Rayne Field* inapplicable and irrelevant here; none of the essentials for a jurisdictional sale are present at any time when the royalty owner exercises any effective control. First

and foremost, the interest being conveyed is clearly distinguishable. There the working interest of a lessee-producer, an established "natural gas company" with full discretion and control over marketing, was being transferred to an interstate pipeline company; here the subject matter is the royalty interest of a party not otherwise involved in the gas sale transaction. Since the royalty interest, in legal effect, has been "reserved," lessee-producer does not have it within his power of disposal. Second, known and developed reserves of gas were conveyed: at the leasing stage, no gas is being transferred, but only the right to explore and to develop and market if exploration is successful. Finally, at the time of the lease, the ultimate destination of potential gas supplies is unknown and the royalty owner can have no knowledge of or control over that decision.

Bastian Bay and *Ship Shoal* serve to clarify and amplify *Rayne Field*, rather than expand upon its substantive holding. In general, they represent a testing of the "development" criterion; but *Ship Shoal* does add a useful dimension by restating and emphasizing the essential character of the phenomenon involved: the significant and determinative economic fact is whether the sale of leases accomplished the transfer of large amounts of natural gas to an interstate pipeline for resale in other States. In short, the economic effect must be the same as a conventional sale of gas. It is difficult to conceive of any rationale by which retention and exercise of a royalty interest can be regarded as tantamount to a conventional sale.

In point of time and the legal and economic interests created, primary lease execution is clearly antecedent to any facet of "production and gathering." The lease constitutes the very essence of the relationship between landowner and lessee-producer. If the language in *F.P.C.* v. *Panhandle Eastern Pipeline Co.* (1949) 337 U.S. 498, 505, holding "leases an essential part of production" is

not controlling here, it is difficult to conceive of a case where it would be. An undeveloped leasehold interest is

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clearly more akin to *Rayne Field* situations than is a passive royalty interest. It has not been suggested that this aspect of *Panhandle* has been reversed or superseded and there seems to be no reason to anticipate such a result here.

The Effect of Prior Regulations and Adjudications

The majority further maintains that the entire matter at issue is settled by the fact that royalty interests have already been subjected to jurisdiction through inclusion as non-signatory interests under regulations in effect since 1954 (presumably sec. 154.91(d), *Regulations Under the Natural Gas Act*). This assumption is in conflict with the same principle of privity that was encountered in connection with the sale theory outlined above.

Any rational application of the regulatory provision involved must require that the signatory and non-signatory interests be substantially identical in dimension and effect. In essence they must be so closely allied as to make the signatory party an agent for the others. But the royalty interest in a conventional oil and gas lease is not a party to the ultimate marketing contract which is in the exclusive domain of the leasehold or working interest.

Similarly, "those selling on a percentage basis" can be construed, reasonably, to include only those holding a percentage portion of the working or leasehold interest. The royalty holder is "selling" nothing; he has granted a development and marketing right out of his total realty interest, with the rental value to be measured by the value of production.

Although it is conceded that brief and unpublished orders issuing certificates to royalty owners in earlier cases

are not decisive of the legal issues here, the majority opinion accepts them as evidence of prior determinations of jurisdiction. Again, the parallels are not apt. In *Elk River* (Docket No. G-11462, June 3, 1957) and *Northern Natural* (Docket No. G-10001, March 23, 1959), the interest retained by the royalty owners was a percentage or fractional part *of the gas produced from the leased properties* which was subsequently assigned to and

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sold by the lessee-producer for the account of the lessor. An agency relationship is thus clearly established, reasonably within jurisdictional reach. In *Northern Natural*, moreover, there was a transfer of working interest bringing the transaction in line with *Rayne Field* and jurisdictional on that ground. Neither case involved the jurisdictional status of a royalty interest expressed in terms of percentage or fraction of the "market price."

The royalty owners acquire no interest in and never become parties to the sale of gas as such. Their interest is a purely monetary one, measured by the volumes of gas produced and its value at the time of production. To ignore the essential difference between royalty and working interests, or to lump them together by indiscriminate generalization, is to beg the very question we are called upon to decide.

The prior actions of this Commission offer no more guiding precedent than do judicial considerations which are not addressed to the royalty interest question.

The Special Circumstances of Denman's R-Lease

While I find it impossible to hold a royalty owner within our jurisdiction under the normal and usual form of a conventional oil and gas lease, not every lease arrangement will fall in this category. This variation does not seem to have been emphasized in any part of our pro-

ceeding. But the Fifth Circuit has pointed out quite clearly (*J. M. Huber Corp.* v. *Denman, supra* at p. 108) that the so-called R-Lease in Docket No. RI67-113 differs from the normal, both in specific content and in its background.

That lease has been introduced as the first item under Exhibit No. 16 in our record. Section IX thereof recites the fact that the gas to be produced from the lease had already been committed to a specific and antecedent marketing contract. We may take official notice of a finding by the Fifth Circuit which explains the origin of this unusual provision. In the initial lease negotiations, the lessor (here represented by Denman) demanded as a condition precedent that the applicant lessee produce a marketing contract as evidence of capability to sell any gas which

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might be found. The potential purchaser was Northern Fuel Supply, an established interstate transporter, now known as Northern Natural Gas Company.

Through the business acumen evidenced in this insistence on a definite market for a product which was then (1936) in surplus supply, the lessor clearly identified his interests with those of the lessee-producer. The privity found lacking in the usual and normal leasing arrangement is supplied under these particular facts. Moreover, the recitation in Section IX of the lease constitutes an affirmative ratification of the sale contract.

The sale to an interstate carrier was consummated at the lessor's insistence and was accepted and ratified by him. He cast his lot and chose to take his chances with the lessee-producer; he must also accept the consequences of that choice. True, the royalty owner could not have known in 1936 that his lease agreement would be subjected to price regulation over thirty years later—but neither could the lessee foresee this development. Since

they joined in a common and mutually acceptable venture, the burdens should fall in equal proportion.

To this extent, I would regard the *Denman* interest under the R-Lease as being bound by Huber's earlier filings. No similar fact situation has been brought to our attention in any of the other cases, but the parties would be free to institute new proceedings where special facts would take a particular lease out of the general rule expressed above.

Abatement of a Burden on Commerce

Some of the parties urging regulation of royalty rate payments would not go so far as to find such rates subject to the Commission's jurisdiction. Rather, we are urged to act on the royalty rate question, isolated from any other aspects of jurisdiction, because the rates allowed under the trend of judicial interpretations will constitute a burden on interstate commerce.

In its broadest context, the power to regulate (and therefore to protect) commerce is an express grant of constitutional authority to the Federal government. When

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the Federal sovereignty in this area has been implemented, State acts which are in conflict must give way. But the constitutional provision is not a universal grant, available under any and all conditions. It is an express and specific allocation of legislative power, and it is Congress that regulates commerce among the States and with foreign nations.

This Commission does not derive its authority from the constitutional grant itself nor does it apply the Constitution in its original terms. We must, therefore, return to the premise on which we started—that our authority, whether it be regarded in jurisdictional or substantive terms, must be found in statute. If the Natural Gas Act

may be interpreted to bring royalty rates within our ambit, then royalty owners are subject to jurisdiction *per se* and we need not indulge in esoteric argument about extra jurisdictional powers over interstate commerce.

Clearly Congress *could* have given us this function; equally clearly, it has not done so. The mere fact that the constitutional power exists does not mean that it has been exercised, and it has been held that the Natural Gas Act did not necessarily occupy completely the total area open to regulation. *F.P.C.* v. *Panhandle Eastern Pipeline Co.*, *supra*, 502. That principal has not been superseded and it is wholly applicable to the "burden on commerce" argument here.

The majority cites *Northern Natural Gas Co.* v. *State Corporation Commission* (1963) 372 U.S. 84, and *U. S.* v. *Southwestern Cable Co.* (1968) 392 U.S. 157, as supporting this theory. Neither seems pertinent since there was not involved any question of authority to act without statutory sanction. In each case it was held that the subject matter was reasonably within the scope of the Federal regulatory statute involved, which is not the case here under my view of the matter.

In conclusion, it is significant to note that we are dealing with past history, albeit there is a current impact. We are asked to assert our jurisdiction on a retrospective basis only. For it can hardly be said that lessee-producers need our protection for future lease transactions.

[5059]

They are clearly on notice that "market price" clauses may be construed in a manner adverse to their interests. One may have ultimate confidence in their capacity to protect their interests in the future by more artful lease draftsmanship.

/s/ John A. Carver, Jr.
JOHN A. CARVER, JR., Commissioner.

Docket Nos. RI67-113 *et al.*

WILLIAM HARVEY DENMAN, Trustee, *et al.*

v.

J. M. HUBER CORPORATION, *et al.*

(Issued July 23, 1969)

O'CONNOR, Commissioner, *dissenting* in part and *concurring* in part:

I agree with Commissioner Carver's conclusions and I would further add:

The majority bases its decision upon a finding of authority in the Natural Gas Act and states "We conclude that if he has contracted to retain an economic interest in interstate sales, he has joined the other interest owners in such sales and he has become a seller of natural gas and, therefore, a natural gas company." Thus, in one broad stroke the majority has wiped out whatever distinctions there may have been between working interests and royalty interests. Apart from the distinctions which Commissioner Carver pointed out, other distinctions exist which further indicate to me that the execution of a lease cannot be considered a sale of gas in interstate commerce. The fact that a royalty interest derives its share free of the costs of operating the lease,[1] or the fact that every jurisdiction where the point has arisen in litigation[2] has

[1] *Shinn* v. *Buxton*, CCA Okla., 154 F.2d 629 (1946), *Duvall* v. *Stone*, 54 N.M. 27, 213 P.2d 212 (1949).

[2] *Indiana Natural Gas & Oil Co.* v. *Stewart*, 45 Ind. App. 554, 90 N.E. 384 (1910).

[Footnote continued on page 477]

defined a royalty as compensation to the owner of the land for the privilege of exploring, developing and producing oil and gas, does not interest the majority. Nor does it cause them to pause and consider whether these distinctions might not mean that the royalty interests involved are different from the other interests in the gas and perhaps should be treated differently. These two distinctions indicate to me that the lease is characterized by the physical acts of production that are expressly exempt from regulation by the Natural Gas Act and, therefore, beyond this Commission's control.

This entire record is based on leases which were signed before producer regulation was envisioned. I cannot believe that any producer today would enter a contract with a lessor wherein he granted more than he would receive for the gas when sold. Putting this another way, I cannot see anyone after today signing anything but a "proceeds" type lease.

As for the effect of the leases in question, the majority has stated that we have jurisdiction only over the producer rates since June 7, 1954, and as such we will only concern ourselves with the gas which flowed from Denman's wells from that date. Like Commissioner Carver, I have problems with the Denman "R"

[5061]

lease in that the lessor definitely tied his interests with the lessee's in demanding as a condition precedent that the lessee produce a marketing contract before the execu-

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[2] [Continued]

Hinerman v. *Baldwin*, 67 Mont. 417, 215 P.1103 (1923).
Vincent v. *Bullock*, 192 La.1, 187 So.35, 39 (1939).
State National Bank of Corpus Christi v. *Morgan*, 135 Tex. 509, 123 S.W. 2d 1036, aff. Com. App. 143 S.W. 2d 757 (1940).
Hickey v. *Dirks*, 156 Kan. 326, 133 P. 2d 107, 109, 110 (1943).
Hinkle v. *Gauntt*, 201 Okl. 432, 206 P. 2d 1001 (1949).
Longino v. *Machen*, 217 Ark. 641, 232 S.W.2d 826 (1950).

tion of the lease. This additional input by the lessor takes the "R" lease out of the usual "hunting license" category characteristic of lease agreements which have only a royalty agreement as opposed to the "R" lease in question with its attendant requirement of a marketing contract.

In *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965), the Supreme Court makes clear that in determining whether a sale of gas has occurred, a functional approach rather than a formal approach must be used. In determining whether the lease sales then in question could be determined to be "sales" of gas in interstate commerce, the Supreme Court said at page 401,

> "The sales of leases here involved were, in most respects, equivalent to conventional sales of natural gas which unquestionably would be subject to Commission jurisdiction under *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672."

also,

> "But, it is perfectly clear that the sales of leases in Rayne Field, a proven and substantially developed field, accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other States. That is the significant and determinative economic fact."

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This language clearly indicates to me that the relevant consideration for determining whether or not a sale of gas in interstate commerce has occurred should focus on all the functional incidents of the transaction rather than the legalistic and formal approach taken by the majority.[3]

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[3] See also, Rev. Rul. 69-355, I.R.B. 1969-26, 9.[Par. 6843] wherein the Internal Revenue Service in a ruling concerning Sec. 172 (1954 Code), *Net Operating Loss Deduction*, held that income

In the usual royalty situation, the incidents of the transaction amount to a real estate transaction rather than a sale of gas. In the instance of the "R" lease, as well as where a lessor takes his royalty in kind and negotiates his own sale, I feel the lessor has brought himself under our jurisdiction. Clearly, in these two instances, the lessor has undertaken to sell gas in interstate commerce for resale.

As for the gas which comes from the "B" and "M" leases, having decided that we have no control over any of the lease provisions, I do not hesitate to say that the royalty owners should get 100 percent of what they bargained for when they executed the leases. That is, they are entitled to receive a percentage of the "market value" as that term may be construed in a forum of competent jurisdiction. The authority of this Commission cannot and should not be inserted to short circuit that result.

Barring the two instances mentioned above, I believe our jurisdiction of the lessee-producers is sufficient in and of itself to guarantee "an adequate supply at the lowest reasonable rates." The point I want to make very clear is that in my opinion the consumer will not suffer from a higher price by not regulating the amount the producer will pay to the royalty owner. This price paid by the producer to the royalty owners falls in the same category as the wages paid to his drilling crews, and the price he pays for the pipe he sinks into the ground. Thus, any bargain struck between the producer and the royalty owner should be allowed to govern. To do otherwise

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received by the taxpayer for the taxable year from a royalty interest was not income derived from his trade or business for the purpose of computing the net operating loss under Sec. 172 of the Code. The Internal Revenue Service said, ". . . A royalty owner is not considered engaged in the trade or business of selling oil and gas where his 'sales' activity is limited to the signing of division orders." Also, ". . . A royalty interest owner is therefore not in the business of producing oil and gas since he has neither the right nor burden of developing and exploiting the property."

would, as I stated in my separate statement to the United States Court of Appeals

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for the Fifth Circuit,[4] entitle the producer to get relief from the royalty owners even though that producer might have been improvident in entering into the lease on terms which, even though they were favorable, could still be reduced by the majority's decision here. Furthermore,

> ". . . Not only would he be insulated from what was an inducement to the lessor to enter into the contract; in addition, he, a pipeline, distributor, or other interested party, could allege before the Commission that the agreement was unjust and unreasonable, requiring a cost investigation into the royalty-owner's operations." [5]

It is for this reason and the others mentioned above that I see no need to expand the jurisdiction of this Commission.

/s/ Lawrence J. O'Connor, Jr.
Commissioner

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[4] Separate statement of Commissioner Lawrence J. O'Connor, Jr., as Amicus Curiae at 31, *J. M. Huber Corp.* v. *William Harvey Denman & Jay Pumphrey*, Trustees for the Estate of S. B. Burnett, deceased *et al.* (C.C.A. 5th 1966).

[5] *Ibid.*

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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Docket No. RI67-113

WILLIAM HARVEY DENMAN, Trustee, *et al.*

v.

J. M. HUBER CORPORATION

Docket No. RI67-114

MOBIL OIL CORPORATION

v.

CARL F. MATZEN, *et al.*

Docket No. RI67-310

WESTERN NATURAL GAS COMPANY

v.

ELMER HENNIGH, *et al.*

Docket No. RI67-400

PAN AMERICAN PETROLEUM CORPORATION

v.

LELAND C. WAECHTER, *et al.*

PRESIDING EXAMINER'S INITIAL DECISION ON JURISDICTION OVER ROYALTY OWNERS

(July 23, 1968)

APPEARANCES

Cecil E. Munn and *H. Carter Burdette* for William Harvey Denman, *et al.*

Thomas O. Moxcey, C. C. Small, Jr., and *Bernard A. Foster, Jr.* for J. M. Huber Corporation

Carroll L. Gilliam, Robert D. Haworth, William H. Tabb, Philip R. Ehrenkranz, Donald G. Canuteson and *Charles B. Swanner* for Mobil Oil Corporation

Bruce R. Merrill, Joseph C. Johnson and *Thomas H. Burton* for Continental Oil Company

Dale M. Stucky, Wayne Coulson, A. E. Kramer, Bernard E. Nordling and *John Prather* for Carl F. Matzen, *et al.;* Elmer Hennigh, *et al.;* and Leland C. Waechter, *et al.*

Cecil N. Cook and *Neal Powers, Jr.* for Old Ocean Royalty Owners Association

Ted Holshouser for Ashland Oil & Refining Company

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John C. Dawson, Glen E. Clover and *Carroll L. Gilliam* for Western Natural Gas Company

Andrew McCollam, Jr., H. H. Hillyer, Jr., and *Jerome J. McGrath* for Land and Royalty Owners of Louisiana

Don H. Coulton and *L. A. White* for Terry Thompson, Jr., *et al.*

John E. Watson and *Robert E. Shaw* for Tenneco Oil Company

C. Daniel Jones, Jr., Crawford C. Martin and *Linward Shivers* for the State of Texas

L. Dan Jones and *William I. Powell* for Independent Petroleum Association of America

C. C. Cammack, Graydon D. Luthey, A. O. Holl and *R. J. Leithead* for Cities Service Oil Company and Columbian Fuel Corporation

Joseph H. French for Kansas Corporation Commission

Kenneth Heady and *John R. Rebman* for Phillips Petroleum Company

Justin R. Wolf, Charles A. Case, Jr. and *Woollen H. Walshe* for the California Company, a Division of Chevron Oil Company

J. P. Hammond, William H. Emerson, J. K. Smith and *R. H. Landt* for Pan American Petroleum Corporation

Jack Fariss for Marathon Oil Company

Sherman S. Poland, James D. McKinney, Stuart J. Scott and *Robert E. Wade* for Atlantic Richfield Company

Martin N. Erck, Frank S. Troidl, D. E. Smith, Jr., and *Robert L. Norris, Jr.* for Humble Oil & Refining Company

William R. Duff for Colorado Interstate Gas Company

Raymond N. Shibley and *William S. Richardson* for Panhandle Eastern Pipe Line Company

Charles E. McGee, John T. Ketcham, Rex Short, and *Charles E. Holmes* for Sinclair Oil & Gas Company

Mary Moran Pajalich, J. Calvin Simpson and *Lawrence Q. Garcia* for the State of California and the Public Utilities Commission of the State of California

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Oliver L. Stone and *Thomas G. Johnson* for Shell Oil Company

F. Vinson Roach, Jack C. Osborne, Patrick J. McCarthy, Frank J. Duffy, Richard J. Connor, Walter E. Gallagher, and *John A. Gale* for Northern Natural Gas Company

James D. Annett, William K. Tell, Jr. and *William R. Slye* for Texaco Inc.

J. Harry Mulhern, Edward S. Kirby and *James R. Lacey* for Public Service Electric and Gas Company

George E. Peabody, Charles V. Wheeler and *Dale A. Wright* for Cities Service Gas Company

Edwin S. Nail for Amerada Petroleum Corporation

Robert W. Maris and *William T. Coleman, Jr.* for Philadelphia Gas Works Division of the United Gas Improvement Company

James O'Malley, Jr., Halcyon G. Skinner and *Leon A. Allen, Jr.* for Consolidated Edison Company of New York, Inc.

Cameron F. MacRae; Halcyon G. Skinner and *Leon A. Allen, Jr.* for Orange and Rockland Utilities, Inc.

E. M. Barrett, Bertram D. Moll and *Morton L. Simons* for Long Island Lighting Company

Edward F. Russell and *Barbara M. Suchow* for Brooklyn Union Gas Company

Samuel Graff Miller and *Donald Blanken* for Philadelphia Electric Company

John Davenport for Texas Independent Producers & Royalty Owners Association

Francis J. Gilmore and *John W. Williams* for the Staff of the Federal Power Commission

KURTZ, PRESIDING EXAMINER: Involved in these proceedings is the question of the Commission's jurisdiction over the payments to holders of royalty interests in natural gas which is produced and transported in interstate commerce for resale.

The controversies arose following the decision of the United States Court of Appeals for the Fifth Circuit in *J. M. Huber Corporation* v. *Denman*, 367 F.2d 104 (1966).

In that case the Court had before it the question of whether or not the Huber Corporation had met the terms of oil and gas leases which provided for payment of royalty based upon the market price or market value of gas produced. The Huber Corporation paid royalty based on the price it received for gas produced under the leases. Although Huber received only 4 to 11 cents per Mcf for the gas sold, the lessors, holders of the royalty interest, contended for a payment based upon an alleged market value of 23 cents per Mcf. The Court on the issue raised as to Federal Power Commission jurisdiction over the royalty interest, found the matter to be arguably within the Commission's jurisdiction and under the doctrine of primary jurisdiction, it should be referred to the Commission for initial determination.

Following the above court decision, William Harvey Denman and Joy Pumphrey, Trustees of the Estate of S. B. Burnett, deceased, and W. K. Stripling, J. B. Thomas, W. A. Landreth, W. L. Stewart,[1] and Perry R. Bass, Trustees of the Mary Couts Burnett Trust, filed on October 17, 1966 in Docket No. RI67-113, a petition for declaratory order seeking a determination that this Commission does not have jurisdiction over royalty payments due them as lessors from J. M. Huber Corporation, the lessee, with respect to natural gas produced and sold by the Huber Corporation to Northern Natural Gas Company for resale in interstate commerce; or in the alternative, in the event that the Commission determines that it has jurisdiction over the royalty payable under the leases to order a further hearing to determine the amount of royalty payable. The gas is produced in Hutchison and Carson Counties, Texas (Railroad District No. 10). Huber on December 8, 1966, filed an answer and a cross-

[1] Mr. Stewart died on July 11, 1967.

complaint to the Denman petition, which was later amended on May 5, 1967, claiming, *inter alia*, that this Commission does have jurisdiction over royalty payments made to Denman, *et al.*, and that such payments must be computed on the basis of the effective rate not subject to refund, as set forth in its FPC Gas Rate Schedule No. 2. Denman, *et al.*, on December 20, 1966, filed an answer to Huber's cross-complaint.

On October 24, 1966, Mobil Oil Corporation filed a complaint in Docket No. RI67-114 to invoke the jurisdiction of the Commission

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over payments to Carl F. Matzen, *et al.*,[2] the owners of lessor royalty interests in natural gas produced from certain leaseholds held by Mobil in the Hugoton Field, Kansas. Matzen, *et al.*, filed an answer on November 28, 1966, alleging that this Commission has no jurisdiction over royalty payments made to them. Mobil on December 20, 1966, filed a response thereto. The complaint was initiated because Matzen, *et al.*, have filed in the courts of the State of Kansas, 283 individual suits against Mobil and one class action with the named plaintiffs acting in their individual capacities and allegedly representing a class of royalty owners similarly situated. Matzen, *et al.*, claim in these suits that they are entitled to royalty payments computed on the basis of rates in excess of the effective rates under Mobil's FPC Gas Rate Schedule Nos. 3, 281, and 282.

On February 23, 1967, Western Natural Gas Company filed a complaint in Docket No. RI67-310 to invoke the jurisdiction of the Commission over payments to Elmer Hennigh, *et al.*,[3] the owners of lessor royalty interests in

[2] Approximately 207 defendants are named and reference is made to 14 of the defendants as representatives of a class of approximately 600 landowners similarly situated.

[3] 15 additional defendants are named.

natural gas produced in the Hugoton Field, Kansas. Hennigh, *et al.*, filed an answer to Western's complaint on March 30, 1967, alleging the Commission is without jurisdiction over the royalty payments. Western filed a response thereto on April 14, 1967. Western's complaint followed a suit brought on April 22, 1965, by Hennigh, *et al.*, against Western in the District Court of Grant County, Kansas, in which they claim royalty payments in excess of the effective rate not subject to refund, as set forth in Western's FPC Gas Rate Schedule No. 17.

On May 11, 1967, Pan American Petroleum Corporation filed a complaint in Docket No. RI67-400 requesting the Commission to institute a hearing to determine whether it has jurisdiction over payments of royalty to Leland Waechter, *et al.*,[4] on gas produced in the Hugoton Field, Kansas. Waechter, *et al.*, filed an answer on June 20, 1967, in which it was asserted that the

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Commission has no jurisdiction over the controversy. The complaint followed a suit by Leland C. Waechter, *et al.*, against Pan American, in the District Court, Stevens County, Kansas, in which they assert the right to collect royalty payments in excess of the effective rate not subject to refund, as set forth in Pan American's FPC Gas Rate Schedule No. 84.

The above dockets were consolidated by Commission orders of April 3, 1967 and June 23, 1967. These proceedings include 34 petitions to intervene, four petitions seeking leave to file amici briefs, and four notices of intervention. On May 8, 1967, the Commission granted the petitions to intervene and the right to file the amici briefs.

In support of the position that the Commission has

[4] 273 additional defendants are named.

jurisdiction over royalty payments on gas moving in interstate commerce and resold, briefs have been filed in the consolidated proceedings by the Staff, The People of the State of California and The Public Utilities Commission of the State of California, J. M. Huber Corporation, Western Natural Gas Company, Pan American Petroleum Corporation, Continental Oil Company, Shell Oil Company, Mobil Oil Corporation, Sinclair Oil & Gas Company, Ashland Oil & Refining Company, Cities Service Oil Company and Columbian Fuel Corporation, Northern Natural Gas Company, Eastern Distributor Intervener Group,[5] Tenneco Oil Company and Texas Independent Producers & Royalty Owners Association.[6]

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The following parties filed briefs in opposition to Commission jurisdiction: William Harvey Denman, *et al.*; Named Defendants in Docket Nos. RI67-114, RI67-310 and RI67-400; Terry Thompson, Jr., Lillian Blanche Brent, R. P. Brent, Jr., Phillip Thompson and L. A. White, Trustee for Miss Georgia Thompson; Old Ocean Royalty Owners Association;[7] and The Land and Royalty Owners of Louisiana.[8]

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[5] The Brooklyn Union Gas Company, Consolidated Edison Company of New York, Inc., Long Island Lighting Company, Orange and Rockland Utilities, Inc., Philadelphia Electric Company, Philadelphia Gas Works, Division of The United Gas Improvement Company, and Public Service Electric and Gas Company.

[6] A nonprofit association representing approximately 4,500 members of which 2,000 are nonintegrated independent producers and 2,500 are royalty owners with mineral interests covering developed or potential crude oil or gas production or both.

[7] Association of over 300 royalty owners in the Old Ocean Field located in Matagorda and Brazoria Counties, Texas.

[8] A nonprofit corporation with members comprised of owners of lands and minerals and royalties affecting more than one million acres of land located in Louisiana.

The order issued April 3, 1967, setting this matter for hearing limited the question at issue and confined the hearing, as follows:

> "Though there may be certain factual differences, the same basic question is presented by the complainants filed by Mobil and Western Natural and the Denman petition: can persons contractually entitled to royalty payments for natural gas sold for resale in interstate commerce be classified as 'natural-gas companies' within the meaning of the Natural Gas Act and subject to the jurisdiction of the Commission. It is therefore appropriate to consolidate these proceedings for hearing as hereinafter ordered. The issuance of this hearing order should not be viewed as the enunciation of the Commission's tentative position that we have jurisdiction over royalty owners. The Commission has not as yet made any such determination of the jurisdictional question and will not until consideration of this proceeding.
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> "The hearing in these cases shall be confined to resolving whether the Commission has jurisdiction over a landowner's royalty interest in natural gas

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> leaseholds and, if answered in the affirmative, how such jurisdiction should be implemented. More specifically the parties should address themselves to the method which should be used in computing gas royalty payments and what additional filing requirements, if any, should be imposed and upon whom.[1]

[1] For example, assuming that the lessor-lessee sale is jurisdictional it may, nevertheless, not be necessary for the royalty owners to make any filing with this Commission. See Section 154.91(e) of our Regulations under the Natural Gas Act."

The Commission specifically in the above hearing order excluded: (1) any question as to its jurisdiction over royalty interest owned by a State, the United States, or

their agencies; (2) contractual issues relating to specific royalty payments to which any particular royalty owner is entitled under a lease agreement; and (3) any question relating to helium except "as the facts on this subject bear upon the royalty interest of landowners in natural gas leaseholds."

By order issued June 23, 1967, the Commission reiterated the question at issue stating: "The common question presented is whether royalty payments made to the lessors named in these proceedings are subject to this Commission's jurisdiction under the Natural Gas Act." It authorized evidence relating to the general industry contracting practices with respect to gas leases so as to be more fully informed as to the general background of the problem and possible economic and legal consequences before making its determination.

There is considerable evidence in the record relating to general industry contracting practices with respect to

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basic provisions in oil and gas lease agreements. Every provision in a lease is open to negotiation, but not every provision is actually negotiated in every transaction. The most common items of negotiation between the lessor and prospective lessee are the amount of cash bonus, the amount of delay rental, the length of the primary term, and the royalty fraction.

The cash bonus is the cash consideration paid by the lessee to the lessor for granting the mineral lease and may range from a minimal amount to a substantial sum.

The delayed rental is a payment for the privilege of deferring the commencement of drilling operations or the commencement of production.

The primary term is the term of the lease during which the lease may be continued in effect without drilling operations or production by the payment of a delayed rental.

The primary term in South Louisiana is usually a period of from 1 to 10 years. There is usually some delay between the granting of a lease and the production and sale of the natural gas.

The landowner may create by grant or by reservation various estates in land. The interest we are concerned with here is called royalty[9] and is created by a

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reservation in an oil and gas lease in which the landowner grants to the lessee certain rights and privileges, such as, to explore, drill and produce oil and gas, and in the same instrument reserves to himself, free from the expenses of production, a share in the oil and gas produced or the proceeds thereof. Williams and Meyers, *Oil and Gas Law*, Manual of Terms, 342; Volume 1, sec. 202, 202.1, 202.3. This share is usually expressed in terms of a fraction of the production. The fraction is generally one-eighth and in some instances a larger amount. The royalty interest as to oil produced is usually taken in kind, but as to gas produced, while the right to take in kind may be reserved, it is seldom done as a practical matter due to its characteristics and the lack of market other than the pipeline to which the lessee

[9] "The term 'royalty' comes down to us through the channels of the old common law of England and its derivation is interesting. Under the theory of land tenure under the feudal system in force and effect in England during the early middle ages, the title to the manor and 'royal mines' of gold and silver was vested in the crown by royal prerogative and, being subject to alienation at his pleasure, was held in fief by the tenants who worked the mines and cultivated the lands under the feudal lords. The tenant held only a 'working interest' so to speak, and produced the crops at his own labor and expense, while the landlords or royal fee owners, holding title direct from the crown, reserved their share of the product of the soil, which share was termed a 'royalty' or that portion belonging to the landlords under royal grant or favor." (Glassmire, *Oil and Gas Leases and Royalties*, Second Edition, page 61).

delivers the gas. The common provisions in the leases for accounting to the lessor for royalty as to the gas produced provide for the lessee to pay the lessor for his fractional part the market value in the field or a percentage of the proceeds derived from the sale of the gas.

In addition to the lessor's royalty interest, there is also another type of royalty interest called an overriding royalty interest. Such interest is most commonly created when a lessee enters into a farm-out agreement with another producer. In such an agreement the lessee retains either an undivided interest in the leases or an override interest. Both the lessor royalty interest and the overriding royalty interest as a contractual matter receive their respective interests free of any of the costs of production, except for taxes. The working interest owners generally share the expenses of development and operation of the property, proportionate to their interest in the property. Although the overriding royalty interest owner is a bare holder of a right to receive proceeds, the lessor royalty interest owner is protected by certain implied covenants with respect to the development of a lease and the marketing of the product.

In Docket No. RI67-113, there are involved three leases as to mineral rights in Texas, designated as the "R Lease" entered into on June 2, 1936, the "B Lease" and the "M Lease" on January 22, 1926. The royalty provision insofar as necessary for consideration here, under the "R Lease" which accounts for 93 percent of the production of gas provides for Huber, the leasee:

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"To pay the Lessors monthly for one-fourth (¼) of the gas produced at the mouth of the well from any gas well, where gas only is found, four cents per one thousand cubic feet for the first ten years of this contract, and thereafter, the market price

of such gas but in no event shall the price be computed at less than four cents per one thousand cubic feet."

Under the B and M Leases the royalty clause provides:

"To pay the Lessor the equal one-eights part of the market value in the field for the gas from each well where gas only is found, while the same is being used off the premises, * * *"

The type of lease varies as to mineral rights in Kansas under Docket Nos. RI67-114, RI67-310 and RI67-400. The royalty clauses in the leases here necessary for consideration generally provide for the lessee to pay the lessor on gas marketed from each well where gas only is found one-eighth of the proceeds if sold at the well, or if marketed by the lessee off the premises, then one-eighth of its market value at the well. Some of the leases set forth only a proceeds type royalty clause and others only a market type royalty clause. Regardless of the type of royalty clause set forth in the leases involved in these procedings, the landowners claim entitlement at the market price.

Under the royalty owners contention, the royalty percent age of the gas sold to the ultimate consumers, 12½ percent or over, will be contractually removed from effective Commission regulation of pipeline gas purchase costs. Payment of the royalty percentage at a higher rate than that prescribed in producers rate schedules as here sought by the royalty owners will affect the cost of gas and ultimately be reflected in rates paid by the consumers in other States.

The main thrust of the royalty owners in opposing Commission jurisdiction is simply that the landowner by the retention of a royalty interest is not the owner of any portion of the gas produced and thus he has nothing to sell. The proponents of jurisdiction advance various arguments against the position taken by the royalty

owners and contend that a sale occurs, with some referring to the relationship between the lessor and lessee at that of a cotenancy and also as a joint enterprise.

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Whatever may be the rights and obligations of the lessor and the lessee under State law, the issue as to the Commission's jurisdiction must be determined under the provisions of the Natural Gas Act. This was pointed out in *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392, 400, (1965) the Court stating:

> "Without impugning in any way the good faith and genuineness of the transactions, we think it clear that the lease-sales here in question can nonetheless be considered 'sales' of natural gas in interstate commerce for purposes of the Act. A regulatory statute such as the Natural Gas Act would be hamstrung if it were tied down to technical concepts of local law."

Nor can an "attractive gap" in Commission jurisdiction be created by ability to frame contractual arrangements to exclude significant portions of jurisdictional gas from regulation. *California* v. *Lo-Vaca Co.*, 379 U.S. 366, 369-370 (1965) Jurisdiction under the Natural Gas Act is not dependent upon the form of the royalty payment set forth in the lease. The Commission in *Texas Eastern Transmission Corporation, et al.*, 29 FPC 249, 256 [10] in holding sales of reserves as being subject to its jurisdiction stated:

> "Any other result would exalt form over substance, would give greater weight to the technicalities of contract draftmanship than to the achievement of the purposes of the Natural Gas Act, and would

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[10] This decision was affirmed in *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965).

impair our ability to control the price received for gas sold to the pipelines in interstate commerce to the detriment of the ultimate consumer. Control limited to approving the costs of the gas to the purchasing pipeline is, of course, not an effective way to regulate producer prices because in the large a pipeline must be allowed to pass on its purchased gas costs to the ultimate consumer or it cannot continue to discharge its public service responsibilities."

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The Commission's regulation of the sales by independent producers began in 1954, after the Supreme Court's decision in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, (1954). Until now the Commission has not been faced with a claim for royalty payment based on a rate in excess of that which the lessee-producer is authorized to collect. The Commission has exercised jurisdiction and required the royalty holder to obtain a certificate of public convenience and necessity, where the lessor has the right, if exercised, to have his fraction of the gas produced delivered to him in facilities at the well provided by him for that purpose.[11]

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[11] On June 3, 1957, in Elk River Coal & Lumber Company (now The Pittston Company) Docket No. G-11462, and on March 23, 1959, in Northern Natural Gas Producing Company, Docket No. G-10001, the Commission found these companies to be Independent Producers of natural gas by reason of the sale of royalty interest gas and issued certificates of public convenience and necessity. Elk River on December 26, 1940, entered into an oil and gas lease with Pittsburg and West Virginia Gas Company (now Equitable Gas Company) and reserved to itself one-eighth (1/8) part or share of all natural gas produced and saved from the leased acreage. The lease provided that Elk River for its interest in gas not taken by it was deemed to be sold to Pittsburg and West Virginia and was to be paid for at the wholesale field market value of natural gas at well. Pittsburg and West Virginia took the seven-eighths interest of the gas which it owned, together with the one-eighth royalty interest and transported the eight-eighths of the natural gas in interstate commerce for resale. Northern Natural Gas Pro-

The declared purpose of the Natural Gas Act, Sec. 1(a) is to regulate matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce.

A natural-gas company is defined by the Natural Gas Act, Sec. 2(6) to mean a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale. The jurisdiction of the Commission is set forth in Sec. 1(b) as follows:

> "The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas."

The Commission's jurisdiction attaches to sales of natural gas in interstate commerce for resale. The Court in construing the above section has pointed out a number of times that the Natural Gas Act is applicable to three separate things: (1) the transportation of natural gas

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ducing Company's application involved five contracts covered an overriding royalty interest of 1/16th of 7/8ths in the gas produced from nine wells and it requested a disclaimer of jurisdiction; or, in the alternative a certificate authorizing the sale. The royalty interest was sold by Northern to its parent, Northern Natural Gas Company, and the gas was transported in interstate commerce for resale. At the time of the issuance of a temporary certificate to Northern and the acceptance of Elk River's increase rate filing in 1956, Commissioner Digby filed a protest as to the Commission "policy decision" exercising jurisdiction over the royalty interests involved.

in interstate commerce; (2) its sale in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or sale. They are independent and equally important regulatory powers under the Act. *Panhandle Eastern Pipe Line Co.* v. *Public Service Commission*, 332 U.S. 507, 516 (1947); *FPC* v. *East Ohio Gas Co.*, 338 U.S. 464, 468 (1950); *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, 681 (1954).

The royalty owners rely upon *Federal Power Commission* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, (1949), which involved the transfer of undeveloped leaseholds from a natural-gas company to its wholly owned subsidiary for sale of the gas in intrastate commerce. This was held not subject to Commission jurisdiction, since it was within the production and gathering exemption of Sec. 1(b) of the

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Natural Gas Act. The royalty owners' position is that since the sale and conveyance of an existing oil and gas lease on undeveloped land is outside the jurisdiction of the Commission, it follows that the creation of the leasehold is likewise outside such jurisdiction. This case is not applicable as we are here concerned with gas moving from developed leases in interstate commerce. This same argument was advanced in *United Gas Improvement Co.* v. *Continental Oil Co.*, *supra*, 402-404 and the Court refused to accept such an interpretation as it would make Phillips [12] a shadow and subject to a matter of timing of the title transfer. The Court went on to state that even though a sale occurs before production and gathering is ended, it is nevertheless subject to regulation, as the production or gathering exemption relates to the physical activities, processes and facilities of production

[12] *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954).

and gathering, but not to sales of the kind affirmatively subjected to Commission jurisdiction.

In *Atlantic Refining Co.* v. *Public Service Comm'n*, 360 U.S. 378, 388-389 (1959), the Court referred to the purpose of the Natural Gas Act, as follows:

> "The Act was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges. * * *
>
> "The overriding intent of the Congress to give full protective coverage to the consumer as to price is further emphasized in § 5 of the Act * * *."

This protection of the consumer, which is the primary aim of the Natural Gas Act, extends to the regulation of all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occuring before, during, or after transmission by an interstate pipeline company. *Phillips Petroleum Co.* v. *Wisconsin*, *supra*, 682, 685 (1954)

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The Supreme Court also pointed out in the recent *Permian Basin Area Rate Cases*, —— U.S. ——, decided May 1, 1968, that it has repeatedly held that the width of administrative authority must be measured in part by the purposes for which it was conferred and the Commission's broad responsibilities demand a generous construction of its statutory authority.

The question of jurisdiction presented in these proceedings does not begin to approach the extent of the Commission's jurisdiction as set forth in *United Gas Improvement Co.* v. *Continental Oil Co.*, *supra*, 401 (1965). The Court's opinion pointed out the history of the transactions leading up to sale of the leases. Regardless of all

this, the Court laid down the rule as to jurisdiction, as follows:

> "But it is perfectly clear that the sales of these leases in Rayne Field, a proven and substantially developed filed, accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other States. That is the significant and determinative economic fact. To ignore it would substantially undercut *Phillips*, and because of it the Commission * * * acted properly in treating these sales of leasehold interests as sales of natural gas within the meaning of the Natural Gas Act."

In a summary opinion, based on the above case, the Court also affirmed the Commission's opinion (30 FPC 1477) holding that it had jurisdiction over the transfer of the Bastian Bay Field leases. *Federal Power Commission* v. *Pan American Petroleum Corp.*, 381 U.S. 762 (1965).

In *Continental Oil Co.* v. *Federal Power Commission*, 370 F.2d 57, 61-62, cert. denied, 388 U.S. 910 (1967), the Court having before it Continental's transfer in the form of lease-sale agreements of certain leasehold interests in the Ship shoals Field held them to be a sale of natural gas in interstate commerce within the meaning of Sec. 1(b) of the Natural Gas Act pointed out that the test is not whether the transaction in question is in form a lease-sale or a sale of gas, as the transaction may be a lease-sale in

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accordance with the local law and a sale of gas under the Act and stated: "The test is three-pronged: (1) Is the economic effect of the transfer similar to that of a conventional sale? (2) Is the subject of the transaction 'proven and substantially developed' reserves? (3) Is

the transfer of the reserves for purpose of interstate transmission and resale?"

The result of the leases here involved is that the interests of both the lessor and lessee in gas produced and sold accomplishes the transfer of natural gas in a continuous flow to an interstate pipeline company for resale in interstate commerce.

The royalty owners do not and cannot claim that the gas is not in interstate commerce. It is immaterial at what point the royalty interest is "sold". In *Deep South Oil Co of Texas* v. *Federal Power Com'n*, 247 F.2d 882, 887 (1957) the Court states:

> "The fact that the sales are made at the wellhead is immaterial for the particular point at which the title and custody of the gas pass to the purchaser, without arresting its movement to the ultimate interstate destination, does not affect the essential interstate nature of the business."

By the terms of the lease the royalty owner has a continuing interest in production as the payment flows from acquisition by interstate pipelines of gas for resale for ultimate public consumption. The leasee must account to the lessor for his share of the volumes of gas produced and compensate the lessor for his retained fraction of the production. The effect is the same as a conventional sale of gas by the lessor to the leassee. To hold that the Commission does not have jurisdiction would defeat the purpose of the Act by a failure to plug a "gap" in the regulation of natural gas. This is clear from *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954). In *FPC* v. *Transcontinental Gas Corp.*, 365 U.S. 1, 28 (1961) the Commission was concerned with the effects that a certificate might have in the future on field prices generally, and the Court stated:

"The point is, as we have stated, that Congress did not desire an 'attractive gap' in its regulatory scheme; rather, Congress intended to impose a comprehensive regulatory system on the transportation, production, and sale of this valuable natural resource. Therefore, when we are presented with an attempt by the federal authority to control a problem that is not, by its very nature, one with which state regulatory commissions can be expected to deal, the conclusion is irresistible that Congress desired regulation by federal authority rather than non-regulation. See *Panhandle Eastern Pipe Line Co.* v. *Federal Power Comm'n*, 232 F.2d 467."

This continuing interest of the royalty owner in rate matters before the Commission is also set forth in the brief filed by Old Ocean Royalty Owners Association, as follows: (p. 4)

"For the most part, those parties taking part in such settlement negotiations simply concerned themselves with the 'area' effect and the overall dollar impact of the entire settlement package. Thus, to such negotiators, a settlement price for one sale, standing alone, had little material significance. This is, of course, directly contrary to the position of royalty owners in a particular leasehold covered by a particular sale, which such royalty owners have as a minimum a 1/8th monetary interest in the gas involved in their particular sale. In spite of their vital and material interest in the terms of any settlement, royalty owners have thus far been excluded from settlement negotiations and afforded no opportunity to object to any of the terms of a settlement prior to its approval by the Commission.

"Therefore, regardless of the ultimate answer to the question of whether the Commission has jurisdiction over royalty interests in leaseholds from

which interstate sales of gas are made, it is necessary and proper, and the Presiding Examiner

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should so recommend, that the Commission amend its regulations so as to provide, in effect, that any independent producer proposing to enter into negotiations for a settlement covering and relating to one or more jurisdictional sales of gas be required to give notice to such effect to all of such independent producer's royalty owners to be affected thereby. Such a regulation would enable a royalty owner to at least have an opportunity to protect his interest in any proposed settlement, and thus do away with the practice to date of simply informing the royalty owner, after the fact, that his interests have been bargained with by other parties at settlement conferences of which he had no notice. The inequities of the present practice are too obvious and too blatant to be any longer ignored."

"The consumer for whom the Natural Gas Act is designed to protect has a real interest in the amount paid for royalty, by reason of the royalty owners now attempting to force the payment for the royalty fraction to a higher rate than that named in filed rate schedules of the producer. The market price for gas, as can be expected, in the unregulated market is higher than allowed under regulation by the Commission. This is not only evidenced by the suits which gave rise to this proceeding but also as shown in the brief above referred to filed by the Old Ocean Royalty Owners Association. Therein it was pointed out that in 1966 over 88,000,000 Mcf of gas was taken from the Old Ocean Field of which over 41,000,000 was sold in interstate commerce to the Natural Gas Pipeline Company of America at 11.4 cents per Mcf and in excess of 47,000,000 Mcf was sold in intrastate commerce at higher prices.

Considering the volumes of gas that move in interstate commerce and the uncertainty of the price to be paid for the royalty interest, which has a direct and substantial effect on the price paid by the ultimate consumer, the Commission must now exercise its jurisdiction to insure the reasonableness of price for gas to the consumer.

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Denman, *et al.*, and The Land and Royalty Owners of Louisiana cite *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944) as holding that the Supreme Court recognizes that Congress was not concerned with royalty owners, or any others, who might have a collateral economic interest in the production and sale of natural gas. This case does not support such a conclusion but quite the contrary. The quoted statements from the *Hope* case refers to the position of West Virginia, which was requesting the Commission to allow a market price in the field higher than the costs of gas transported by Hope so as to promote the economy of the State. While the Court recognized that both the lessor and lessee had valuable property interest in the gas which was separately taxable under West Virginia law, it could not find in the words of the Act or in its history the slightest intimation or suggestion that the exploitation of consumers by private operators through the maintenance of higher rates should be allowed to continue provided the producing states obtain indirect benefits from it.

A further statement as to the position of West Virginia in the *Hope* case is found in *Columbus, Ohio* v. *United Fuel Gas Co.*, 5 FPC 279, 292 (1946) wherein the Commission pointed out;

> "In addition to the contentions of West Virginia agencies that the price of gas at the well mouth

should be fixed at 15 cents per M.c.f., which we have previously discussed, these parties contend that in determining reasonable rates for the respondents, production must be entirely separate from transportation and distribution, and that the formula heretofore applied by this Commission for determining the cost of production is of improper applicability. These same contentions were advanced by the State of West Virginia and the Public Service Commission of West Virginia in *Federal Power Commission* v. *Hope Natural Gas Company* (320 U.S. 591), and the Court said:

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> 'We have considered these contentions at length in view of the earnestness with which they have been urged upon us. We have searched the legislative history of the Natural Gas Act for any indication that Congress entrusted to the Commission the various considerations which West Virginia has advanced here. And our conclusion is that Congress did not.' "

The Land and Royalty Owners of Louisiana in support of its position that the legislative history discloses an intent of Congress not to include the holders of royalty interests within the jurisdiction of the Commission, calls attention to the Crosser Bill (H.R. 5711, 75th Congress, 1st Session) and the Lea Bill (H.R. 4008, 75th Congress, 1st Session, the forerunner of the Natural Gas Act).[13] The Crosser Bill was not enacted or even seriously considered. During the hearing on the Lea Bill language from the Crosser Bill requiring the filing of contracts including lease and royalty agreement was sought as an amendment to what is now Sec. 4 of the Act, which relates to the establishment of rates and charges. This

[13] The Lea Bill as amended became H. R. 6586, 75th Congress, 1st Session.

proposal as to the filing of such agreements was objected to by Mr. William Dougherty, representative of the pipeline companies, on the grounds of additional expense and such filings were of no value until there was a rate case and if need they could be obtained at that time. The mandatory filing proposed under this section was not adopted. The proposal to include the right of the Commission to require the filing of lease and royalty agreements with respect to a determination of gas reserves in what is now Sec. 14(b) was adopted. Neither of these proposals support the position of The Land and Royalty Owners.

The claim is advanced that the failure of the Commission to assert regulatory jurisdiction over royalty prices is persuasive as to the lack of such jurisdiction. The short answer to this is, except for the *Northern* and *Elk River* instances, the Commission has not heretofore been called upon to pass on the jurisdictional question. Nor has it been faced with a claim for the payment of royalty at a rate in excess of that which the producer is authorized to collect.

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Various proposals have been made as to how jurisdiction over the royalty interest should be implemented. Some proposals would effect a determination of contractual issues relating to specific royalty payments to which a particular royalty owner is entitled under a lease agreement by restricting payment to the level of the rate received by the producer or the area rate named by the Commission. Such a determination of specific royalty payments was excluded from consideration herein by the above Commission hearing order. The royalty interest is similar in many respects to a percentage interest held by an independent producer in a lease who is not a signatory to a gas sales contract. Under Section 154.91 (d) of the Regulations under the Natural Gas Act applicable

to producers, a non-signatory interest owner to a jurisdictional gas sales contract is not permitted to file a certificate application or rate schedules in the absence of a waiver for good cause (see Rules of Practice and Procedure, Section 1.7(b)). This practice was upheld in *Sun Oil Co.* v. *FPC*, 256 F.2d 233, *cert. denied*, 358 U.S. 872 (1958). This is the same approach that the Commission has taken with respect to percentage sales contracts between a producer and the operator of a processing plant where the producer sells its gas to the plant operator at a price that is determined on the basis of a percentage of the proceeds from the jurisdictional resale of the residue gas by the plant operator (see Section 154.91(e) of the Regulations under the Natural Gas Act). The Commission's Regulations do not presently provide for separate filings by royalty owners who are not themselves signatory parties to the gas sales contract.

The burdening of the Commission and royalty owners as to filing requirements should be avoided as far as feasible. It would appear that the Commission's processes need be invoked only in those instances where the royalty owner asserts a claim for a higher price for his fractional share of the gas over that which the producer or lessee is authorized to secure. It is not necessary or advisable at this time to adopt requirements governing royalty interest beyond recognizing the right of the royalty owner to file for an increase. Any regulations beyond this should be based upon a general rule making proceeding applicable to all royalty owners.

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ADDITIONAL FINDINGS AND CONCLUSIONS

Upon consideration of the record and the briefs filed in these proceedings it is further found and concluded that:

(1) The provisions of the Natural Gas Act apply to persons entitled to royalty payments for natural gas sold for resale in interstate commerce and the royalty payments are subject to the jurisdiction of the Commission under the Act.

(2) No additional regulation governing filing requirements are required at this time, except as hereinafter ordered.

ORDER

WHEREFORE, IT IS ORDERED, subject to review by the Commission:

(A) The royalty owners in Docket Nos. RI67-113, RI67-114, RI67-310 and RI67-400 are natural gas companies as defined in the Natural Gas Act.

(B) A royalty owner seeking an increase in the royalty payment over and above that received from the producer shall set forth in the application to the Commission the existing rate of payment per Mcf, the higher rate of payment claimed and the factual information relied upon in support of the increase, including all agreements relating to the royalty interest.

/s/ Alvin A. Kurtz
ALVIN A. KURTZ
Presiding Examiner

APPENDIX E

Natural Gas Act, Sections 1(b), 2(6), 4(a), 4(c), 4(d), 4(e), 5(a), 19(b)

The Natural Gas Act, 52 Stat. 821 (1938), as amended, 15 U.S.C. § 717, *et seq.*:

Section 1(b). The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas. [52 Stat. 821 (1938); 15 U.S.C. § 717(b)]

* * * *

Section 2. When used in this act, unless the context otherwise requires—

* * * *

(6) "Natural-gas company" means a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale. [52 Stat. 821 (1938); 15 U.S.C. § 717a]

* * * *

Section 4(a). All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

* * * *

Section 4(c). Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this act takes effect)

and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

Section 4(d). Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulations, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

Section 4(e). Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service,

but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible. [52 Stat. 822 (1938); 76 Stat. 72 (1962); 15 U.S.C. § 717c]

Section 5(a). Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification

is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order; *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates. [52 Stat. 823 (1938), 15 U.S.C. § 717d]

• • • •

Section 19(b). Any party to a proceeding under this act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application

for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in [former] sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, sec. 1254). [52 Stat. 831 (1938); 15 U.S.C. § 717r]

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

MOBIL OIL CORPORATION, Petitioner, vs. CARL F. MATZEN, et al., Respondents.	No. 71-1169
AMOCO PRODUCTION COMPANY, Petitioner, vs. LELAND C. WAECHTER, et. al., and THE LAND AND ROYALTY OWNERS OF LOUISIANA, Respondents.	No. 71-1179
CITIES SERVICE OIL CO., Petitioner, vs. CARL F. MATZEN, et al., Respondents.	No. 71-1188
SHELL OIL COMPANY, Petitioner, vs. CARL F. MATZEN, et al., Respondents.	No. 71-1191
FEDERAL POWER COMMISSION, Petitioners, vs. MOBIL OIL CORPORATION, et al., Respondents.	No. 71-1326

BRIEF IN OPPOSITION FOR RESPONDENTS CARL F. MATZEN, et. al. and LELAND C. WAECHTER, et. al.

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STATUTES

Natural Gas Act, as amended, 15 U.S.C. § 717, *et seq.*:

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BRIEF IN OPPOSITION FOR RESPONDENTS CARL F. MATZEN, et. al. and LELAND C. WAECHTER, et. al.

Mobil Oil Corporation, Amoco Production Company and their supporting intervenors, Cities Service Oil Company and Shell Oil Company, have petitioned for certiorari. They were subsequently joined by the Federal Power Commission. These Respondents oppose.

QUESTION PRESENTED

The question is solely one of law, which can be fairly stated as follows:

Is a landowner a natural-gas company under the Natural Gas Act and are the amounts of monthly cash rental payments due to him under a mining lease subject to regulation by the Federal Power Commission if the lease permits lessee to use the leased premises for the purpose of manufacturing, mining, producing, saving and taking care of natural gas in commercial quantities thereon with an obligation to compute such cash rental payments as royalty, and the lessee, after such use, sells to others for its own account the natural gas so produced (owned solely by it as produced by it) for resale in interstate commerce?

STATEMENT OF THE CASE

The facts are undisputed.

Unfortunately, they are largely obscured in the petitions for certiorari. Because the Commission, made up of both lawyers and laymen, had no expertise as a body regarding the applicability of the facts to common law rules, it sought and received evidence regarding the state of the law, and the state of the law turned out to be undisputed.

The following statement therefore includes a summary of undisputed evidence regarding common law principles universally applicable governing the lessor-lessee

relationship involved. If this statement appears to be contrary to assertions made in the petitions, it is not because they are disputed but because of a certain ambivalence, only a few instances of which we will bother to point out as illustrative in footnotes as we go along.

Description of Parties, Leases, Leasehold and Marketing Activities

Each of these respondents, Carl F. Matzen, et al. and Leland C. Waechter, et al., is the owner of a tract of farm land in Western Kansas or a part thereof. The tracts vary in size, but the majority contain 160 acres. Each owner's interest is burdened by an oil and gas lease.

The leases vary in their language, but are conventional in form and include provisions of which the following can be described as fairly typical:

> "1. That lessor, for and in consideration of the sum of _____ Dollars ($_____), in hand paid, and of the covenants and agreements hereinafter contained to be performed by the *lessee* has this day granted and *leased* and hereby *grants leases* and *lets* unto the *lessee for the purpose of mining* and *operating* for and *producing* oil and gas, casinghead gasoline, laying pipe lines, building tanks, storing oil, building powers, stations, telephone lines and other structures thereon to produce, save, take care of and *manufacture all of such substances*, and for housing and boarding employees, . . ."
>
> "2. This lease shall remain in force for a term ending _____, and as long thereafter as oil, gas, casing-

head gas, casinghead gasoline, or any of them is produced."

* * *

"4. The lessee shall monthly pay lessor as royalty on gas marketed from each well where gas only is found, one-eighth (⅛) of the proceeds if sold at the well, or if marketed by lessee off the leased premises, then one-eighth (⅛) of its market value at the well .... Lessor shall have the privilege at his own risk and expense of using gas from any gas well on said land for stoves and inside lights in the principal swelling located on the leased premises by making his own connection thereto.

"Where gas from a well or wells, capable of producing gas only, is not sold or used for a period of one year, lessee shall pay or tender as royalty, an amount equal to the delay rental as provided in paragraph (5) hereof, payable annually at the end of each year during which such gas is not sold or used, and while said royalty is so paid or tendered this lease shall be held as a producing property under paragraph numbered two hereof."

"5. If operations for the drilling of a well for oil or gas on said land or for gas, on a consolidated leasehold estate of which this land is a part thereof, as contemplated in paragraph 9, are not commenced on or before _____ this lease shall terminate as to both parties unless the lessee shall on or before that date, pay or tender to the lessor, or to the lessor's credit in the _____ Bank at _____, or its successors, which bank and its successors are the

lessor's agent and shall continue as the depository of any and all sums payable under this lease, regardless of changes of ownership in said land or in the oil and gas, or in the rentals to accrue thereunder, the sum of _____ Dollars ($_____), which shall operate as rental and cover the privilege of deferring the commencement of drilling operations for a period of one year. In like manner and upon like payments or tenders, the commencement of drilling operations may be further deferred for like periods successively . . . ." (Ex. 4, R. 1152, Italics added)

Among the owners of such leases are petitioners Mobil Oil Corporation, Amoco Production Company and Cities Service Oil Company.

Leasehold operations were conducted on the leased premises by the respective lessees. Such activities eventually included natural gas production activities in the Kansas Hugoton Gas Field area through lessees' use of the land and wells drilled by them thereon.

The lessees were and are the first owners of all the natural gas they produce, as produced by them. In some instances the lessee had assigned leasehold interests to others, such as lease brokers or farmoutees. (For typical instruments see R. 1984-2010). Such lease assignments carried with them, or reserved in lessee, a fractional co-ownership interest in and to the natural gas as and when produced. Such ownership interest in natural gas is sometimes referred to as an overriding "royalty interest". (R. 1946)

The lessors themselves neither have nor retain nor obtain such ownership[1] or royalty interest[2] in the natural gas production. They have no natural gas or co-ownership interest therein to sell.[3] (Court of Appeals, Opinion, Shell Pet.; p. 9a-11a).

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1 Mobil, on page 3 of its petition, states:

"Under state law, the various interests in the *total volume* delivered from a given well are classified principally as 'working' interests and as 'royalty' interests." As related to gas production involved in these cases, the statement is incorrect. We are confident this must have been unintentional. The interests mentioned could be more fairly described as interests in *leases*. They certainly cannot be described as interests in volumes of natural gas. Mobil then states that the working interest owner is the lessee and goes on to describe the lessor royalty interest in terms of a "percentage or fraction (e.g., 1/8)". From these references it might be inferred that the owners of the so-called working interest in the leases in question (the lessees) own a part of the volumes of natural gas delivered from a well, while the owners of the so-called royalty interest in the leases (the lessors) at some time own the other part of such volume. We are confident that Mobil must not have intended to create this impression, since it is admitted that this is not and has never been true. (A similar, erroneous inference is created on pages 7 and 8 in Mobil's petition with reference to certificate and rate filings.)

2 Cities Service, Amoco and Cities in stating the question presented, and all petitioners elsewhere, refer to respondents' royalty interests *in natural gas*. They thus identify the interests of landowners with the overriding "royalty interests" of assignees from the lessee, above described. These royalty assignees of lessee, along with the lessee itself, are the only ones who have an ownership interest in the gas. They do not include the landowner-lessors. We feel confident that such use of words was not designed to confuse the Court. Nor is Mobil's inference in its footnote on page 6 of its petition, which could suggest that respondents are not lessors and part-owners of the leased premises.

3 Mobil describes a "division order" as certifying lessors' "interest in natural gas delivered under rates schedules on file with the Federal Power Commission." (Mobil Pet., 7) Mobil surely did not intend to suggest that the landowner has any legal or equitable, possessory or non-possessory, interest in natural gas so to certify or that any such so-called "division order" refers to anything but cash amounts due as rental compensation to be made in accordance with the lease terms, and not as a division of volumes sold. (R. 1957-8)

The lessees and their assigns use and market the commodity solely on their own account under a variety of arrangements, eventually marketing the same in three states of matter — gaseous, liquid and solid. (R. 2049)

That part marketed (or used) by lessee in gaseous state not lost in transmission is sold by the lessee and its assigns to pipelines for resale in interstate commerce or is used by lessee as fuel in compressor stations, or is sold for other local purposes prior to delivery of the residue to the pipelines.

That portion marketed in liquid state (which is a part of a gaseous volume when produced) results from use of the natural gas by the lessee off the leased premises in removing valuable hydrocarbons which become liquefied (such as propanes, butanes and natural gasolines), which are then marketed by lessee off the leased premises, with only the residue gas remaining being delivered in gaseous state to pipeline companies. (R. 2030, 2040-2042)

The part marketed in solid state results from another use by lessee or an affiliate of the natural gas off the leased premises. That part is sold as carbon black, a residual of the combustion of the natural gas in facilities built for that purpose, marketed off the leased premises. (R. 2049)

All leasehold and marketing activities are carried out by the lessee and its assigns on their own account without any participation by the lessor. Lessor had no

"say" and no right to have a "say" regarding marketing. He had no role to play and played no role. His only relevant activity was signing the lease which gives him no rights regarding marketing (R. 1152, 1153). If he was curious, he tried to find out, if he could, what was going on, on his own land, and what was happening to the natural gas after production. (Much of such information is learned after a suit is filed.)

The lease typically gives lessee the privilege of using gas free of charge from any gas well in the principal dwelling house on the particular leased premises. If landowner-lessor wants to use the gas for any other purpose, such as for fuel to power irrigation pumps on the very leased premises, he is in the position of a complete stranger, — he must negotiate at arms-length, if he can, a separate purchase contract with his own lessee for the sale of the natural gas to him.

The lessee is obligated under the particular leases in question to pay the monthly rental computed as royalty, in *cash* and *not in kind*. Such payments are in amounts based on the amount of production each month. They are further related to a value factor described by use of words such as "market value", "market price", "wellhead value", "proceeds", etc.[4] Distinctions are made based on the various places and methods of marketing or uses to which the lessee puts the gas, the relevant value usually being on the leased premises and not at a place of delivery away

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4 Shell pet., 35a-36a

therefrom after gathering, liquid extraction, etc.[5] (R. 1152, 1153)

As a result of the cash payment requirement and the various possible marketing conditions, the royalty is computed based upon *a percentage of the value* of the entire quantity commercially produced each month rather than upon the value of a *percentage of the production.*

Under the leases in question, the percentage is one-eighth. The leases refer to one-eighth of the appropriate value factor. None of them refer to one-eighth of the amount produced. (R. 1152, 1153)

Nature of Disputes Between Lessor and Lessee and Resulting Litigation

Disputes arose between the landowners and lease owners as to the amount of royalty payments which had become due each month by reason of production activities by lessee over a past period of months. They finally resulted in traditional lawsuits brought by landowner-lessors in Western Kansas in 1963 through 1965.

The litigation was of the same nature as litigation which has been going on for over a century between other landowner-lessors and their oil and gas lessees.

The nature and extent of such litigated dispures is revealed by the summary of the controversies with Amoco and Mobil which follows.

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5 Sometimes a proceeds-less-expense formula is used to arrive at a value on the leased premises when the gas is used and marketed off the leased premises in both liquid and gaseous state. See, for example, *Matzen v. Hugoton Production Company,* 182 Kan. 456, 321 P.2d 576 (1958)

Amoco as lessee beginning in 1954 made monthly payments amounting to .9375 cents per Mcf of the gas produced up to 1.5 cents per Mcf including 1.34 cents and 1.375 cents, plus in many instances (and in those instances with respect to each varying figure above mentioned) small additional payments by reason of an incremental value on the leased premises of liquefiable hydrocarbon content marketed by it off the leased premises through its own use of the produced gas (R. 2023-2026, 2030, 2053)[6] Amoco had, part of the time, computed its base payments through the use of a uniform per Mcf figure and all of the rest of the time by using varying per Mcf figures during each month, depending on whether the part of the natural gas sold in gaseous state was sold by it or was sold by its farmoutees (co-owners of the gas with it by reason of assignment of working interests in the leases) with the figures varying part of the time within the limits above mentioned depending upon which of its co-owners sold such produced gas and upon their proportionate ownership. (R. 2022-2030)

In 1963 Amoco began to withhold from the landowners' monthly compensation so variously computed by it as currently due, amounts it claimed it had overpaid during monthly periods nine years before that time. (R. 2022-24)

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6 All amounts are stated in the section based on values of per thousand cubic feet (Mcf) of all gas produced, at a pressure of 14.65 pounds per square inch absolute, with equivalent values stated where measurement is on another pressure basis.

The landowners asserted claims for additional amounts by reason of production after June of 1961 only, claiming that Amoco was obligated as primary and base lessee to assure monthly rental payments after that time based on a uniform value on the leased premises of 1.8125 cents per Mcf of all gas produced (regardless of such differing percentages of ownership in others), in addition to the incremental value by reason of the liquefiable hydrocarbon content separately marketed off the leased premises. They also resisted Amoco's affirmative claims of right of offset for alleged overpayments made during past months. (R. 2040-1)

Mobil, with respect to one group of leases, beginning in 1954 paid royalties amounting to 1.375 cents per Mcf produced, later reduced to a little over one-half of a cent per Mcf then increased to something below one cent per Mcf and later further increased to 1.375 cents per Mcf. In the latter part of 1965 Mobil first began to pay small additional incremental amounts by reason of the enhanced wellhead value of all of the gas produced by reason of its liquefiable hydrocarbon content separated and marketed by it off the leased premises. (R. 2039, 2024, 2040)

Additional adjustments in past payments were also made after the landowners filed suit when it was discovered that, notwithstanding the removal of liquids, shrinkage and fuel used in plants, Mobil had been selling more residue gas than the monthly amounts it had theretofore reported that it was producing. (R. 2041)

In December of 1964 it began withholding from current monthly payments, computed as above stated, amounts it claimed it had overpaid in months ten years before that time. (R. 2040)

The landowners claimed that Mobil was contractually obligated in recent years to make monthly payments amounting to about two cents per Mcf by reason of its production of all gas whether marketed by Mobil in gaseous or liquid state, compared with Mobil's claims that it was obligated over the period involved to make payments amounting to a little over 1.375 cents per Mcf produced in addition to varying small incremental monthly amounts by reason of the value on the leased premises of the liquefiable content removed and marketed by it through its use of the gas off the leased premises. (A. 2040-1, 2048)

With respect to a second group of leases, beginning in 1954 Mobil made payments amounting to 1.375 cents per Mcf with a reduction in 1957 to less than a penny. After suit was filed against it, it tendered a retroactive payment into court of additional amounts designed to make total payments amounting to 2.093 cents per Mcf for one period, down to 1.375 cents per Mcf for a later period, back up to 2.093 cents per Mcf for a still later period, and back down to 1.375 cents per Mcf. (R. 2045)

From the amount otherwise due under this retroactive adjustment, it deducted sums which it claimed to be due to it for alleged overpayments made for months many years before, when it was making payments amounting to 1.375 cents per Mcf, thus unilaterally recovering everything it

had paid except that amounting to less than a cent per Mcf. (R. 2045-6)

As to a third group of leases, Mobil made royalty payments amounting to 1.375 cents per Mcf produced for a period of time and then reduced payments so that they would amount to less than a penny per Mcf produced. (R. 2049) After suit was filed and in March of 1965 it tendered into court a purported retroactive accounting for additional royalties. The basis of payment for the adjustments was such as to result in total payments amounting to 1.875 cents for one period, decreased to 1.375 cents for a later period, increased back up to 1.875 cents for a still later period, and decreased back down to 1.357 cents thereafter, with Mobil withholding, in connection with such tender, amounts claimed due to it for earlier months. (R. 2049, 2047)

As to the second group of Mobil leases, landowners claimed that since December 1, 1958, they had been entitled to payments amounting to 2.093 cents per Mcf. produced and as to the third group of Mobil leases that they had been entitled to payments amounting to 1.875 cents per Mcf. produced, in both instances resisting Mobil's claims of a right of offset as to overpayments allegedly made during many months before that. (R. 2043-2049)

In summary, leases claimed that monthly royalties should be paid at figures since 1954 amounting to about a half cent per Mcf. produced to over two cents during later periods, with the landowners claiming that payments

amounting to a little over two cents per Mcf. should have been made consistently during later months.

The lessees engaged in motion practice, vigorously asserting what appeared to be every possible traditional defense. Landowners began filing individual suits. Because of the relatively small amounts for each landowner as compared with the great array of legal, technical and expert resources available to these major oil companies (a full allowable for one well is based upon 640 acres), groups of landowners attempted to change their actions into class actions and began filing class actions in the first instance. This was resisted by lessees and no class orders were or ever have been entered in the cases. (For representative state court pleadings, see R. 2021-2050, 1545, 2052, 2064, 2124, 2130, 2137, 2145, 2155, 2157, 2159, 2170, 2181, 2183, 2185, 2189, 1544-1559, 1561-1563, 1567-1571, 1151, 1154, 1855-1863)

Proceedings Before the F.P.C. and Review Thereof

Before any determination as to any substantive issue could be made, lessees seized upon an entirely new strategm. In 1967, Mobil and Amoco suddenly brought complaint proceedings against the landowners before the Federal Power Commission and Cities Service intervened. Each complaint was brought by a lessee against all of the landowners with whom it had such a dispute. In such complaints the lessees claimed, for the first time, that the respondents were natural-gas companies under the Natural Gas Act and that the amount of such monthly payments due to them

as lessors from the lessees were subject to direct regulation by the F.P.C. They also claimed that the landowners were violating the Natural Gas Act in seeking traditional judicial remedies to recover the contractual monthly amounts alleged to be owing to them under the leases.

The state court judicial proceedings were then stayed by federal court order at the instance of lessees and the landowners were required to go to the nation's capital, where they were introduced for the first time to the strange and baffling mysteries of expensive and lengthy administrative proceedings before the Federal Power Commission.

The respondents had theretofore been complete strangers to Commission regulation. They had never been parties to any proceedings before the Commission. They had not made or been required or notified to make any filings or appearances of any kind before the Commission.

The Commission was equally unfamiliar with landowners and leases. It had never considered disputes between such lessors and lessees. The Commission had no expertise as a body in this area, being unfamiliar with the lessor-lessee relationship. It affirmatively requested and received evidence as to the legal nature of the oil and gas leases and their economic consequences, above described.

The complaint proceedings were consolidated with somewhat similar proceedings previously filed by others,[7] and a divided Commission, by a 3-2 majority, found and held in the order on review[8] that the landowners were

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7 Resulting from the case of *J. M. Huber Corp. v. Denman*, 367 F.2d 104 (1966), Shell pet., 88a

8 Shell pet., 27a-40a

natural-gas companies, that the lease provisions requiring such periodic royalty payments constitute "sales" for resale in interstate commerce under the Natural Gas Act, and provided for implementation of its asserted jurisdiction in an attempt to regulate the amount of such payments retroactively to 1954.[9]

In its opinion, the Commission isolated out of the integrated lease that single portion containing the particular royalty formula.[10] It then isolated out of the royalty formula the particular words referring to the value of the gas, described by it as "proceeds", "market value", "market price", "wellhead value", etc.[11] It held it had jurisdiction over such isolated words for the reason that they resulted in a payment "based upon the production of natural gas in interstate commerce."[12] It found the "basic fact" to be "the effective retention by the royalty holders of a percentage interest in the gas sold in interstate commerce."[13] It held that whether "under private law"[14] the lessors ever had a legal or equitable, possessory or non-possessory, interest in such commodity first owned and sold by lessee and its assigns was not determinative.

It thus justified its departure from long established law on the basis of its description of such lease rental provision as an arrangement under which the lessor "retained" an *economic interest* in interstate sales sufficient

9 Shell pet., 39a-40a
10 Shell pet., 35a
11 Shell pet. 35a-36a
12 Shell pet., 36a
13 Shell pet., 34a
14 Shell pet., 35a

to describe that particular lease rental transaction as a "sale".

Various judicial review proceedings instituted by both sides were consolidated in the United States Court of Appeals for the District of Columbia Circuit. That Court, in a carefully reasoned unanimous decision[15] reversed on the grounds that neither the statutory language nor congressional intent justified such an attempt to extend the jurisdiction of the Commission.

REASONS FOR DENYING THE WRITS

This case involves only private contract disputes between landowners and their major oil company lessees. The lessees seek to avoid paying rent they agreed to pay many years ago. They conceived of the Commission's legitimate concern for the ultimate consumer as a possible instrumentality to achieve their purpose of enhancing their own profits. They convinced a majority of a sharply divided Commission that a century of real estate law could be obliterated by turning a rental transaction into a sale of a commodity on the theory that Congress in 1938 sought to protect the consumers from being exploited by farmers.

Some added scheme was necessary also to create additionally, out of thin air, a regulated "rate" for the pretended "sale". They therefore suggested that the Commission accept a loan for this purpose of their own service rate filings covering a different "sale" (an actual one) of natural gas made by them and their co-owners to

15 Shell pet., 1a-26a

others. The result was an attempt to make the landowners the only regulated persons in the history of our nation whose "rates" would be regulated, not by any examination of the economic impact upon them of the regulation, but solely by reference to the expenses, profits, investments, facilities, contracts, risks, tariffs, costs and allowed returns of other persons engaged in a completely different business. The sought-for order, in effect, ignored all of the provisions of the Natural Gas Act, except the word "sale", and all rules and regulations of the Commission thereunder.

But this flagrant attempt to misuse administrative regulation has not survived judicial scrutiny. The result reached by the Court of Appeals is so obviously correct that this Court should not be burdened with its consideration. The result could only be further delay with many more landowners joining the many who have already died since the state court suits were filed.

ARGUMENT

This Case Involves No Unusual or Substantial Question of National Concern

This case involves private contract disputes. Recovery by landowners of any additional royalty would affect the companies' stockholders only. The first sale in interstate commerce was and is already 100%, regulated as to 100% of the natural gas sold in interstate commerce, with no gap in regulation. F.P.C. jurisdiction is complete, the rates are fixed and the consumers protected.

The lease rental payments to landowners fall in the same category as rental payments on the companies' offices, wages paid to executives and drilling crews, and all other payments made by the lessees in connection with the production of natural gas. All of such costs result from agreements between the lessee and unregulated third-parties.

The Commission's theory of "economic benefit" to the lessor applies equally to all persons who derive economic benefit by being paid for goods or services furnished to them by lessees by reason of and in connection with the existence of its gas production activities.

In each instance a bargain is struck between the lessee and the person furnishing the land rented, the goods supplied or the services performed. That bargain is allowed to govern subject to the power of the Commission, in fixing producer rates, to determine the reasonableness of such costs not directly subject to its regulation.

The distinctions sought to be made between a situation where a flat sum is paid and one where it is based on a percentage is spurious.

In entering into rental agreements, the rental is always based upon what the parties feel is the use-value of the land. In the case of mining leases, that value is difficult to provide for and to measure when provided for. This means that, unlike similar provisions in other percentage leases based solely on net income, profits, etc.,

the mathematical formula in the gas lease requires the use of percentage factors relating to values not necessarily reflected by direct figures on lessee's books of account.

This case is here only because such use-value was disputed under the variety of marketing arrangements above described, the lessees unilaterally made judgment decisions as to what values they would use from time to time in computing and tendering payments — they are not billed by the lessors — litigation resulted regarding the proper amount of rental payments, and the lessors committed *lese majesty* against lessees in attempting to unite and use a judicial class action remedy hopefully available in recent years.

The existence of lawsuits resulting from such traditional disputes is of no more legal significance in the light of the Natural Gas Act than any other dispute involving expenditures of a lessee-producer.

This case does not present anything of national significance more than would be presented by any other dispute which the lessee would have concerning the amount owed by it to third-parties who furnish the resources which enable it to carry on its natural gas production activities.

These companies obviously paid landowner-lessors as little as they thought they could get by with. When challenged, they joined together in massively resisting the effort to get them to pay their debts. And they coercively

suggest that the recent possibility of landowners' use of class actions justifies transforming landowners into proper subjects of administrative regulation, thus attempting to avoid defenses for judicial determination. A more straightforward approach would be to frankly attempt explicitly to exempt major oil companies from the judicial rules providing for class actions.

As stated by Commissioner O'Conner in his dissent:

> ". . . I believe our jurisdiction of the lessee-producers is sufficient in and of itself to guarantee "an adequate supply at the lowest reasonable rates." The point I want to make very clear is that in my opinion the consumer will not suffer from a higher price by not regulating the amount the producer will pay to the royalty owner. This price paid by the producer to the royalty owners falls in the same category as the wages paid to his drilling crews, and the price he pays for the pipe he sinks into the ground." (Shell pet., 61a).

The Decision Below Is Correct

The opinion of the Court of Appeals is obviously carefully thought out, reaches the correct result and faithfully follows all previous decisions of this Court.

Section 1(b) of the Natural Gas Act states the full extent of its applicability:

> "The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial or any other use, and to natural-gas companies engaged in such transportation of sale,

but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas." 52 Stat. 821 (1938), 15 U.S.C. 717 (b)

Section 2(6) (Definitions) defines a "natural gas company" as:

"'Natural Gas Company' means a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale." 52 Stat. 821 (1938), 15 U.S.C. 717a (6)

No more explicit statement of the scope of the Act could be made than that set forth by this Court in *Panhandle Eastern Pipeline Co. v. Public Service Commission*, 332 U.S. 508, 516 (1947):

"... Three things and three only Congress drew within its own regulatory power, delegated by the Act to its agent, the Federal Power Commission. These were: (1) the transportation of natural gas in interstate commerce; (2) its sale in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or sale. ..."

No claim is made that respondents transport natural gas or are engaged in its transportation. Accordingly, respondents are subject to regulation only if they sell gas in interstate commerce for resale.

There is no indication anywhere that Congress did not have in mind the ordinary, usual and natural sense of the word "sale" when the Act was passed thirty-five years ago. And, as was pointed out by the Court of Appeals in

the decision below,[16] this would be particularly true because "sale" is not one of the terms for which Congress provided an express or supplemental definition in the portion of the Act, 15 U.S.C. Sec. 717a (Definitions), defining terms.

This Court, in cases before the enactment of the Natural Gas Act, described the production activities carried on by lessees as purely local mining and manufacturing operations carried on by use of the soil whereby a commodity which did not previously exist is created by lessee. *Champlain Refining Co. v. Corporation Commission*, 286 U.S. 210, 235 (1932); *West v. Kansas Natural Gas. Co.*, 221 U.S. 229, 255-256 (1910); *Burnet v. Harmel*, 287 U.S. 103, 107 (1932). As the Court below pointed out,[17] this Court in the *Burnet* case observed the lack of incidents of a "sale" by a landowner-lessor under an oil and gas lease, both in technical terms and common understanding.

It is beyond dispute that courts have universally defined the payment of lessor royalty to landowner as payment for the use of his property in the nature of rental.

Nor is there anything else which shows the intent of Congress in 1938 to include such rental transactions within the meaning of the word "sales", or to include the fragmentated activities of the embattled dust-blown farmers of Western Kansas within the definition of a natural gas company. The 1938 Act was based upon Federal Trade Commission reports.[18] Certainly the thousands of farmers

16 Shell pet., 9a
17 Shell pet., 10a-11a
18 52 Stat. 821 (1938), 15 U.S.C. Sec. 717a

of this country were not included within the "handful of holding companies" who created the "specific evils" found by that Commission to exist and to which Congress addressed itself. See *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944).

The intent of Congress is also clearly demonstrated by the fact that all other language in the Act, in addition to the word "sale", is incomprehensible if sought to be applied to landowners and leases. As the Commission found out when it attempted to shoe-horn the landowners into the Act at the behest of the oil company lessees, there is no language in the Act that anybody (except an administrative body regulating to protect the regulated) can apply with a straight face to landowners or their leases. The language of the Act makes absolutely no sense when an attempt is made to apply it to landowners.

The Commission ran into the problem at the outset. Section 4(c) of the Act, 15 U.S.C. Sec 717(c),[19] requires that every natural gas company" file with the Commission within 60 days of the date of the Act in such form as the Commission may prescribe[20] and keep open in convenient

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19 Mobil App., 109

20 The Commission has never made any rules or regulations relating to landowners or leases. The producer regulations are effectively limited in language to apply only to lessee and his assigns (including over-riding royalty interest owners), *who are co-owners of the natural gas*. Lessees have filed lists of the names and percentage of ownership of everyone whose natural gas is being delivered under the rate filings made by lessees. They have covered 100% of the gas. They have not purported to name any landowner or cover any interest presumed to belong to him, nor has the Commission ever suggested they should. Nor does it now so suggest. Those same regulations require the filing of some document authorizing the operator to sell the gas belonging to the co-owners. Yet nobody has filed an oil and gas lease.

form and place for public inspection schedules showing all "rates and charges" for any jurisdictional sale and all "classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner may affect or relate to such rates, charges, classifications and services."

If the Act were applied to landowners, they would be required publicly to display their lease contracts. Presumably, tacking a lease contract on the wall paper in the front room next to the motto "God Bless Our Happy Home" would be sufficient for an indulgent Commission, although it might be more acceptable to tack it out of the weather in an outhouse or in a shed on the farm more accessible to the public.

Either realizing the absurdity of an open and admitted attempt to apply this crucial section of the Act to landowners and leases or in order to avoid being inundated by hundreds leases requiring the Commission to regulate all leasehold activities and the many inter-related lessor-lessee covenants resulting from the integrated instruments (and probably for both reasons), the Commission entered its ordering paragraph (B) fiat:

> "For regulatory purposes such sales are covered by the filings of the producer-operators and payments made by the producers to the royalty owners should be made as provided by the contractual provisions of each lease, except that in no event should the payment exceed the just and reasonable rates as fixed by the Commission under the Act."[21]

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21 Shell pet., 40a

The rate schedules filed by lessees as independent producers under the Act are contractual agreements made solely between them and a pipeline company, together with all agency authorizations in the case where the lessee acts as selling agent for non-signatory co-owners of the natural gas. The landowners are not parties, signatory or non-signatory, to these contracts or any such agency agreements and are not in any way legally bound by them.[22]

Assuming that the lease is an agreement for the purchase and sale of gas, the lessor is the *seller* and the lessee is the *buyer.*

In order to camouflage the inapplicability of Section 4 of the Act, the Commission had to conceal the fact that regulated rates must be contractual in the first instance, filed by *seller.* This was concealed by administrative fiat eliminating the statutory requirement of a seller filing under the pretense that the lessees' contracts with others, in which lessee is the *seller* is the identical contract under which he is a *buyer* from lessor.

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22 The argument that some "agency" might exist between lessors and lessees (see F.P.C. pet., 9) is specious. How could an agent agree to sell for a price other than agreed upon in the lease contract which is presumed to create the agency? We do not understand the reason for Amoco's reference to a claim of a fiduciary duty with respect to its gaining a higher price for gas (Amoco pet., 4) unless it also is an attempt to infer agency. The reference is obscure, but probably relates to the landowners' position, squarely contrary to that suggested by Amoco, that lessees could not possibly be considered acting as lessor's agent and that Amoco's and Mobil's rates could not possibly be considered as applying to landowners royalty payments in view of their practice of making price concessions in nation-wide settlements as to gas produced by them on Kansas premises in return for higher prices elsewhere in the interest of their stockholders.

As a further cover-up, the Commission found it necessary to ignore even a part of the royalty provisions of the lease relating to quantities produced. Otherwise, it would be readily apparent from the face of the order that the royalty payment was only a cash rental transaction.

This is clearly seen when it is remembered that rental payments are computed upon the entire produced volume, however marketed or used by lessee for its own purposes, and that, on the other hand, the lessee's gas sales contracts which it makes as seller of its own gas cover only the volumes ultimately delivered for resale in interstate commerce to pipeline companies.

The produced volumes used in computing the rental payments frequently are of greater value on a per Mcf. basis because those volumes contain, at that point, gaseous hydrocarbons which are later marketed by lessee to others in liquid state at equivalent per Mcf. prices that are greater than the per Mcf. prices for the volumes ultimately delivered by lessees to pipeline companies. So there is no identity of per Mcf. value either.

Assume a value on the leased premises of 16 cents per Mcf., including the value of liquefiable hydrocarbon content then in gaseous state. The landowners are to be paid based not on such value but on one-eighth of such value, or on the basis of 2 cents per Mcf. Assume, also, that the per Mcf. value of the residue gas finally delivered in interstate commerce by the lessee, after its use of it for other purposes, is 14 cents. If the rental payments are

considered as payments for the sale of gas, the per Mcf. price for the gas "sold" by lessor to lessee is one-eighth of that, or only 2 cents, while the sales price for gas sold by lessee to the pipeline company is 14 cents, or seven (not eight) times greater.

What the Commission did was to ignore that part of the rental computation which refers to the fact that the landowner is "paid", under a sales theory, for *all* of the gas produced and marketed or used. It pretended that the royalty is "paid" for only *one-eighth of the natural gas.*

The Commission disregarded this lack of identity of activities, quantities and values in stating that "the interests of the royalty owners are covered by the filings of producer-operators . . ."[23]

Under the Commission's order, it makes no difference what the percentage applied might be. If the percentage is 1/8th, the "price" due the landowner (assuming a value on the leased premises value of 12 cents) is 1.5 cents per Mcf.; if the percentage is 3/16th, the "price" is 2.25 cents per Mcf. Under the Commission's order, each is equally a fair and reasonable "rate" under the Natural Gas Act.

It is apparent from the above that, although the order was written so as to have general application, the order was effectively designed to protect only those lessees, petitioners here, who talked the Commission into entering it.

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23 Shell pet., 40a

But more to the point, the above demonstrates beyond a doubt that it takes a lot of verbal shenanigans coupled with unspoken and concealed legerdemain to try to make it appear that the Natural Gas Act can be adapted as a rent-control measure. If this seems to be a harsh criticism, Commissioner Carver said the same thing in different words. He described the order of his colleagues as a "bootstrap conclusion" which "taxes credulity to the breaking point"[24] made "with only the most general reference to statutory criteria and in reliance on precedents that have no direct bearing on the present issues.[25]

He also stated:[26]

> "In order to support a finding that royalty owners have participated in a sale of natural gas, it is essential that some specific operative act, some definite transaction, be identified as having the legally accepted characteristics of a 'sale.' * * *
>
> "We don't know the majority's theory in this respect, because the issue, and indeed the whole matter of how a sale occurs, is evaded by a forensic *tour de force.* The fact of a sale is declared, rather than demonstrated by any acceptable rationale. And we are told that technical concepts of law have no bearing since this Commission is not bound 'by Hornbook definitions or local decisions not applicable to the Natural Gas Act.' There is little doubt that this is an accepted benchmark in rule case law, * * *

24 Shell pet., 46a
25 Shell pet., 45a
26 Shell pet., 47a-48a

"But we are not at liberty to enlarge that principle into an unrestricted license to snatch our own definitions out of the cosmos, hand-tailored to fit the case, any more than problems of construction can be swept away by denigrating reference to established legal concepts. The precise task at hand is to give meaning and effect to the 'sale for resale' criterion of jurisdiction and to measure the concept of a mineral lease against that standard. Absent some clear indication that Congress meant to abandon and deny accepted principles of property and contract law, they should be used as interpretive guideposts and aids to construction.

* * *"

This Court as early as 1871 considered and defined the word "sale" and quoted a learned author as saying, "If anyone of the ingredients be wanting, there is no sale." *Butler v. Thompson*, 92 U.S. 684 at 685 (1876). Here all ingredients are lacking.

Who is the seller? Under the Commission's order it is simply asserted that landowner is the seller. But the Commission does not consider him a seller under Section 7 of the Act requiring him to receive a certifcate authorizing leasing of land by him. Nor is landowner considered a seller under Sections 4 and 5 of the Act assuring reasonable rates after giving consideration to the possible economic effect of regulation upon him as seller.

The cynicism with which the oil companies approach the entire matter is demonstrated by Mobil's reference to the royalty payments as a "windfall". (Mobil Pet.,

26) This is reminiscent of the following testimony before the F.P.C. in an area rate case drawn to the writer's attention by a friend:

> "Q. Do you consider that the bonuses and royalties paid by the producer to the lessor or landowner constitute economic rent to the landowner?
>
> "A. (Dr. Kahn) Yes.
>
> "Q. Does that mean there should be no compensation to the landowner?
>
> "A. Do you want my opinion or — it is a little hard to know how to answer this. In my judgment there should be *no compensation* to the landowner, or his compensation *should be taken away from him by the government.*" [Emphasis added]. (Transcript of Proceedings in South Louisiana Area Rate Proceedings, p. 13, 267)

How depriving landowners of this "windfall", the only compensation landowners receive by reason of *any* use of their land during production activities, will enhance the supply of natural gas (short of prior socialistic confiscation by Congress of interests in land) is nowhere explained by Mobil, although it and other petitioners pretend to be concerned about the supply of natural gas.

Who is the buyer? Under the order, the filings of the producers control. Under those filings, the only buyers are the pipelines. But jurisdiction is urged by reason of the royalty provisions of the lease, which, construed as a sales agreement, makes lessee the buyer. In reliance upon the lease agreements the lessees now seek, as buyers, retroactively to recover refunds and place limitations on

the amount they were contractually required to pay and did pay.

What is the contract of sale? Although Section 4 of the Act, as above stated, requires filing of all classifications, practices and regulations affecting rates and charges, together with all contracts which in any manner affect or relate to the same, the Commission and the proponents of what is essentially rent control are required by their "sales" theory to ignore all provisions of a fully integrated lease instrument except for the single word "value" or its equivalent.

What is the place of delivery? The leases do not, of course, provide for a place of delivery, since nothing is sold and no delivery is contemplated. There is no commodity to be delivered. All of the real, honest-to-goodness contracts for the first sale of 100% of the gas contain this ingredient.

The next question is, what is the price?

As pointed out above, lessees here have claimed that royalties should be computed in amounts resulting in payments ranging from less than a half-cent per Mcf. produced beginning in 1954 to over two cents during later periods, with the landowners claiming that payments should have been consistently made during later periods at a little over two cents per Mcf., and resist lessee's claims for refunds for alleged overpayments during earlier monthly periods.

The higher per Mcf. prices in the real gas purchase contracts in the range up to over sixteen cents are other

than the per Mcf. figures on which payments have been made to landowners, other than those which lessees claim they should have made, other than those which landowners claim, and other than those applicable on the leased premises on anybody's theory.

All of these anomolies result from trying to make a sale out of a rental transaction. The values of less than one-half to two cents per Mcf. on the leased premises constitute the agreed-upon use-value of the land while used for gas production purposes. They are paid as rental in the same manner as in other percentage leases. None of the indices of sale of a commodity are needed or present. These are the only rentals which lessor receives for all activities and uses during production activities. The use value of the land is continually reduced as production continues, resulting in the public policy of recognition of such deteriorating value through depletion allowance in the absence of other provisions for depreciation on unimproved land.

On the other hand, the higher values set forth in the contracts between the lessees and the pipeline companies are intended as payment for an actual sale of natural gas, with all indices of sale being present.

The Natural Gas Act obviously was not intended by Congress to be a rent-control measure to regulate rents under types of ordinary leases known to it to exist long before the Act was passed. It was designed to regulate "sales", a legal concept equally well known at the time, none of the ingredients of which we have present.

There Is No Conflict of Decisions

The *Rayne Field*,[27] *Ship Shoal*,[28] *and Bastian Bay*[29] cases, upon which petitioners rely, all admittedly involved actual and not pretended sales. All of the ingredients of sale above mentioned were admittedly present, including computed quantities but the lessees claimed that the economic effect of a conventional sale of gas could be avoided by making leases, rather than natural gas, the *subject* of an *admitted sale*. The court found that this was just a dodge. However viewed, the lessee was an admitted selier. The ownership of *all* of the natural gas came along with the lease sale. The pipeline became the owner of all of the gas, as it would under the conventional sale of natural gas. The indicia of sale including quantities under developed leases were identical whether the subject matter sold was described as a lease or as natural gas. Indeed, the cases are directly contrary to petitioners' position here, because they clearly show that all of the indicia of natural gas ownership produced under a lease is in the lease owner and not in the landowner.

Rayne Field certainly was not intended by this Court as a license to ignore traditional rules of contract law. In that case, the new arrangement was carefully drawn in such a way that it would result in virtually the same economic effect as traditional arrangements. Only the form was changed. On the other hand, the arrangement here is a traditional one — a rental arrangement that existed

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27 *United Gas Improvement Company v. Continental Oil Co.*, 381 U.S. 392 (1965)

28 *Continental Oil Co. v. FPC*, 5 Cir., 370 F.2d 57 (1966)

29 *FPC v. Pan Am Petroleum Corp.*, 381 U.S. 762 (1965)

long before the Natural Gas Act. No change has been made with the view of changing the status of anyone or any transaction.

That royalties paid pursuant to an oil and gas lease have never been payments for the sale of gas results not from technical rules governing such transactions, but from the physical and economic facts surrounding the lease transaction. The proponents of F.P.C. jurisdiction in this case do not ignore technical rules of state law to give effect to an underlying economic reality. They turn *Rayne Field* upside down and, inventing a new rule of law, use *Rayne Field* to destroy the underlying economic reality. In *Rayne Field,* the lessees were told that the clever use of words would not prevail over the facts. But they are back at it again, attempting the same thing. By the use of clever words, they attempt to free themselves from the facts.

As stated by the Court of Appeals below:

"When we came to an ordinary lease by the landowner to the producer there is neither a 'customary' sale in interstate commerce nor its equivalent in economic effect. Such a lease is a transaction that is itself customary and conventional, but one that precedes the 'conventional' sales in interstate commerce with which Congress was concerned, indeed even precedes the 'production and gathering' which § 1(b) visualized as preceding the sale in interstate commerce over which jurisdiction was being established.

"Turning to the 'significant and determinative economic facts,' basically the significant fact for a sale

in interstate commerce is interstate movement either by the seller, prior to or in connection with the sale, or by the purchaser, typically an interstate pipeline company, subsequent to or in connection with the sale. In the case of a typical oil and gas lease, there is no such interstate movement by either the transferor or transferee." (Shell pet., 14a-15a)

Shell relies on a theory that no sale exists but that the attempted expansion of jurisdiction might be justified on a burden-on-commerce theory.

Merely because royalty payments might affect the ultimate price to the consumer is not a ground for regulating them. Every expense of a natural gas company has that effect.

Numerous substantial items of cost are incurred by natural gas companies. Among other things, companies buy pipe, purchase leases, pay bonuses, hire well-servicing units, hire drilling equipment and pay for pipeline right-of-way. Each of these items represents a cost which could perhaps raise the price of gas to the consumer. As a result, if desirability of regulation alone were sufficient to create the power to regulate, the Commission should have power to regulate each of these items. But, of course, it has no such power. The provisions of 15 U.S.C. 717(b) define the limits of the Commission's power. Those limits have nothing to do with what is desirable. Instead, they depend upon whether the person sought to be regulated is engaged in the business of selling natural gas. Unless Congress has constitutionally delegated to that administrative agency

the power to regulate the particular transaction, the administrative agency has no such power. *Federal Power Commission v. Panhandle Eastern Pipeline Company,* 337 U.S. 498 (1949). Congress has not seen fit to expand the Commission's jurisdiction.

CONCLUSION

As we pointed out to the Court below, one is reminded of the medieval inn-keeper. If the guest was too long for the bed, his feet were chopped off; if too short, he was put on the rack and stretched. A few guests died that way, but they always fit the bed. A similar operation was performed here both on landowners and leases, all in an attempt to avoid judicial determination of questions of local import.

The careful decision of the Court of appeals is correct and faithful to all pronouncements of this Court. The petitions for writ of certiorari should be denied.

Respectfully submitted,

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

MOBIL OIL CORPORATION, *Petitioner* vs. CARL F. MATZEN, et al., *Respondents*	No. 71-1169
AMOCO PRODUCTION COMPANY, *Petitioner* vs. LELAND C. WAECHTER, et al., *Respondents*	No. 71-1179
CITIES SERVICE OIL CO., *Petitioner* vs. CARL F. MATZEN, et al., *Respondents*	No. 71-1188
SHELL OIL COMPANY, *Petitioner* vs. CARL F. MATZEN, et al., *Respondents*	No. 71-1191
FEDERAL POWER COMMISSION, *Petitioner* vs. MOBIL OIL CORPORATION, et al, *Respondents*	No. 71-1326

Brief in Opposition for Respondents William Harvey Denman Et Al

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Brief in Opposition for Respondents William Harvey Denman Et Al

Mobil Oil Corporation, Amoco Production Company and their supporting intervenors, Cities Service Oil Company and Shell Oil Company, have petitioned for certiorari. They were subsequently joined by the

Federal Power Commission. These respondents oppose. Because of the necessity to respond to five separate petitions, this brief is somewhat longer than we would have preferred.

QUESTION PRESENTED

The pivotal issue is solely one of law. It may be fairly stated as follows:

> Is a landowner who grants an oil and gas lease—on which the lessee subsequently discovers and produces natural gas which the lessee sells in interstate commerce for resale—a natural gas company so that royalties owing under the terms of the lease are subject to regulation by the Federal Power Commission?

The Court below answered that question, properly we believe, in the negative.

STATEMENT OF THE CASE

The basic factual context from which that question arises is helpfully uncomplicated.

A landowner grants an oil and gas lease. By authority of that conveyance the lessee drills wells which produce gas. The lessee sells that gas to an interstate pipeline. Pursuant to the lease obligations the lessee pays royalties to the landowner with respect to the lessee's gas production. The landowner reserves none of the gas production. He is not a party to the sale by the lessee nor does he necessarily agree that

the royalty is to be calculated on the basis of the lessee's price to the pipeline.[1]

The Origin of the Litigation

A short explanation of how these cases arose will place the controversy in needed perspective.

William Harvey Denman and other named trustees (the Burnett Trustees) are the owners of the Burnett Ranch in West Texas.[2] A controversy with J. M. Huber Corporation to whom they had granted an oil and gas lease is the genesis of the litigation now before this Court.

Since 1947 Huber had refused to honor its leasehold obligations as to the manner of computing royalties on natural gas production. It used first one excuse and then another for its refusal. After Huber's gas sales became subject to FPC regulation as a result of the 1954 decision in *Phillips*,[3] Huber added a new contention; namely, that such regulation entitled it to disregard the royalty obligations agreed to in its oil and gas lease and unilaterally to substitute a "proceeds" clause of the type which the Burnett Trustees

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[1] In many cases the landowner *does* agree to royalty calculated as a share of the lessee's sales proceeds. In those situations the problem envisioned by petitioners would not ordinarily arise. In very rare instances the lease may entitle a landowner to take, as royalty, a share of the gas in kind and sell it himself to a pipeline. In that event, the landowner would have made a sale to an interstate pipeline which of course would be jurisdictional. But no such situation is involved here and in the gas production industry it would be atypical.

[2] The beneficiaries of the trust are Texas Christian University and an attractive lady by the name of Anne Burnett Windfohr Tandy who lives but a few miles from Texas Christian University in Fort Worth, Texas.

[3] *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954).

had expressly refused to accept when the lease was granted in 1936.[4]

To resolve the dispute the Burnett Trustees filed suit in the United States District Court which considered and rejected Huber's contentions, including its argument that the FPC was the proper forum for the decision of such controversies.[5] On appeal the Fifth Circuit affirmed the rejection of all of Huber's substantive contentions. With respect to the argument that the lease controversy should proceed before the FPC, it declined judicial consideration of that jurisdictional issue until the Commission had first had a go at it. But the Court meticulously cautioned:

> "Lest we be misunderstood, we emphasize again that this analysis is merely to indicate why we conclude primary jurisdiction reference should be made, the Court all the while disclaims any purpose by what it has said or left unsaid, by its comments, express or implied, of declaring or intimating what its views are on the questions

[4] In *J. M. Huber Corporation* v. *Denman*, 367 F.2d 104, 109 (5th Cir. 1966), the Court pointedly observed:

> "Realizing as they had to, that the earlier and *rejected* draft of February 19, 1936, had an express 'net proceeds derived from the sale of gas' royalty clause which was in effect replaced by the 'market price' clause (note 4, supra) the Lessee-Producer's reported declarations made through its general counsel — a voice not only of management, but with an articulate awareness of the significance of legal terms — clearly put its construction of a market, not a proceeds, basis on this royalty clause. There were similar representations made to the FPC that under its gas leases 'it is obligated to pay royalty based on the market price at the wellhead.'"

[5] *Denman* v. *J. M. Huber Corporation*, 231 F.Supp. 746 (N.D. Tex. 1964).

referred for initial decision by the FPC and the arguments pro and con."[6]

Following that mandate, the Burnett Trustees petitioned the Commission for an order disclaiming jurisdiction or, in the alternative and in the event the Commission should assert jurisdiction, an adjudication of the controversy.[7] At that point three other oil companies (Mobil, Western Natural[8], and Amoco) who had litigation with their lessors pending in Kansas petitioned the FPC to take jurisdiction of their cases. The Commission consolidated the three petitions, held hearings, received an examiner's recommendation and, by a 3-2 decision, asserted jurisdiction over the landowners and provided for its implementation. All parties appealed and the Court of Appeals for the District of Columbia reversed, unanimously holding that neither the statutory language nor the Congressional intent justifies such an extension of FPC jurisdiction.

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[6] *J. M. Huber Corporation* v. *Denman*, 367 F.2d 104, 120-121 (5th Cir. 1966).

[7] In obedience to the Fifth Circuit that procedure was followed notwithstanding this earlier telegraphic disclaimer from the FPC, set out at 367 F.2d 118 n. 49:

> ". . . Federal Power Commission does not fix royalty rates between a lessor and lessee nor does it have any procedure to adjudicate such a dispute."

[8] Western Natural subsequently settled all of its controversies, leaving only three complaining oil companies. See FPC petition p. 5 footnote 4.

REASONS FOR DENYING THE WRIT

(Summary of the Argument)

The carefully considered opinion of the Court of Appeals faithfully followed this Court's prior decisions. The case presents no unresolved issue of law. Nor, contrary to contentions of *some* of the petitioners, does it reduce FPC jurisdiction. Rather the decision below merely repudiates the efforts of a handful of major companies to *expand* that jurisdiction beyond its statutory limits as clearly defined by this Court:

> ". . . Three things and three only Congress drew within its own regulatory power, delegated by the [Natural Gas] Act to its agent, the Federal Power Commission. These were: (1) the *transportation* of natural gas in interstate commerce; (2) its *sale* in interstate commerce for resale; and (3) natural gas *companies* engaged in such transportation or sale."[3]

The decision below is sound. Neither by granting an oil and gas lease nor by accepting royalties on gas production from that lease does a landowner make a sale of natural gas—in law, in fact, or in substance. The term "sale" is used in the Act in a natural, not a distorted, sense. Typically the lessee sells 100% of the gas and the FPC in fact regulates that 100% sale. There is neither statutory basis nor economic need to extend such regulation behind the sale and to the royalty provisions or other terms of the lease from which the gas is produced.

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[3] *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*, 332 U.S. 507, 516 (1947). All emphasis in quotations is ours unless noted otherwise.

The theory expressed in the opinion of the Commission majority that a *part* of an oil and gas lease constitutes a jurisdictional sale—while at the same time recognizing that the lease itself is nonjurisdictional—created serious contradictions with the Act itself and was properly reversed by the court below.

The theory expressed in the Commission's petition for certiorari that the lessee is an agent of the landowner so that the sale by the lessee to the pipeline is in reality a sale by the landowner to the pipeline—besides contradicting the Commission's decision below—is clearly contrary to fact. The inescapable consequences of such a theory are self-refuting.

An extension of Commission jurisdiction over provisions of oil and gas leases would inject chaos into an already confused gas regulatory scheme. The legislative history of the Act negates any Congressional intention for FPC regulation of landowners who receive royalties on gas production.

Shell's argument to stretch jurisdiction to whatever affects interstate sales of gas is contrary to the statute itself and to this Court's prior decisions.

The decision below is consistent with this Court's prior decisions. The conflicts which petitioners urge were carefully considered by the court below and properly rejected. There is no rational basis for suggesting that traditional oil and gas lease forms, which were designed by oil companies and in use long before the Natural Gas Act was passed, were a landowners' subterfuge to avoid regulation under that Act.

The controversy is private in nature and of rather limited interest. Petitioners' efforts to find a novel issue of national concern are contrived and unavailing. Their exaggerations in that attempt are extreme and obvious.

ARGUMENT

This case presents one of many types of controversies which arise from time to time between landowners and their oil and gas lessees over the interpretation of oil and gas leases or with respect to operations on those leases. It is of a private nature and—notwithstanding the exaggerated protestations of the four major oil company petitioners—does not involve any crisis issue of monumental national import.

The anomalous effort of those few companies is to expand FPC jurisdiction into new and uncharted areas as a mandatory alternative to judicial resolution of issues which are typically judicial. The lack of candor of some of the petitioners is illustrated by the following comparison of assurances to the Court in two of the petitions for certiorari:

Mobil Petition	Shell Petition
". . . the Commission affirmed exercise of such jurisdiction for almost eighteen past years, but the Court of Appeals has reversed, . . ." (p. 3).	"The issue of jurisdiction over royalty claims is admittedly a new one for the Federal Power Commission as well as the Courts." (p. 15).
". . . a rate regulatory program already operative for almost eighteen years [has] been overturned with no remand to the agency." (p. 25).	

The truth is that the FPC never before has asserted jurisdiction over landowners except in two isolated instances of sales by them of gas reserved in kind.

The pretense that the Commission has heretofore established royalties payable under oil and gas leases is answered by the Commission itself. In an *amicus curiae* memorandum filed at the request of the Fifth Circuit in *J. M. Huber Corporation v. Denman*, 367 F.2d 104 (5th Cir. 1966), the Commission acknowledged that the argument was new to it:

> "Since the Commission has not had occasion to pass upon this important question as to the scope of its jurisdiction, we are not in a position to express any definitive position thereon at this time."[10]

Writing separately in that same Memorandum, Commissioner O'Connor was even more explicit:

> "Inquiring parties have, on numerous occasions, been given the information that gas royalty payments were outside the present regulatory responsibilities of the Commission, and it takes little imagination to conclude that such inaction indicates a lack of jurisdiction. . . . In the context of long understanding of Commission policy, the position is unavoidable that the Natural Gas Act has not up to the present been construed to encompass royalty-owners."[11]

After hearing from all parties the Court below put

[10]Page 2 of Memorandum for the Federal Power Commission Amicus Curiae, filed in *J. M. Huber Corporation v. Denman*, 367 F.2d 104 (5th Cir. 1966).

[11]Ibid. p. 23.

this matter in focus:

> "The Act was passed in 1938 and it has not heretofore been construed to apply to ordinary lessors. While inaction is not controlling on intent, the widespread assumption and acquiescence therein, including administrative and legislative acquiescence, extending over such a great period of time is not lightly to be brushed aside."[12]

The magnitude of the statutory stretch which petitioners seek to evoke from this Court is exposed by Amoco's description of "the instant case involving jurisdiction over many thousands of royalty interest owners" and its footnote reference to witnesses who "estimated the number to be hundreds of thousands in Louisiana alone".[13] The Congress has found no need to confer such regulatory jurisdiction. Nor should this Court do so.

The Decision Below Is Sound

Petitioners would support the extension of jurisdiction which they seek by urging that a landowner receiving royalties from a producer on gas production from land is a natural gas company who makes a "sale" of gas in interstate commerce for resale. The Court below, in a carefully reasoned opinion, correctly concluded that a landowner simply does not make a sale of gas:

> "To refer to the royalty owner as engaging in the sale is to depart from the common understanding of the words used, industry parlance,

[12]Shell pet., App. pp. 8a-9a.
[13]Amoco pet. 15.

> economic equivalent, or any other foundation hitherto considered a source for discerning Congressional intention."[14]

The three members of the Commission who urged the jurisdictional extension disapproved by the Court below never really came to grips with the decisive question, "Where is any *sale* by a landowner?" Commissioner Carver, dissenting, perceptively exposed this fatal deficiency in the reasoning of the FPC majority:

> "In order to support a finding that royalty owners have participated in a sale of natural gas, it is essential that some specific operative act, some definite transaction, be identified as having the legally accepted characteristics of a 'sale' . . . We don't know the majority's theory in this respect, because the issue, and indeed the whole matter of how a sale occurs, is evaded by a forensic *tour de force*. The fact of a sale is declared, rather than demonstrated by any acceptable rationale."[15]

To contrive a sale where none exists petitioners imply that the concept of a "sale" as that term is used in the Act—and presumably in this Court's decision[16]—carries some mysterious yet-to-be-articulated definition. Such an approach defies the established guidance from this Court:

> "As we have often said, 'the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses.' "[17]

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[14]Shell pet., app. p. 15a.
[15]Shell pet., app. p. 47a.
[16]See note 9 page 6 above.
[17]*Malat* v. *Riddell*, 383 U.S. 569, 571 (1966); *McNally* v. *Hill*, 293 U.S. 131 (1934); see *Old Colony RR* v. *Comm'r.*, 284 U.S. 552, 560 (1932).

And, as pointed out by the Court below:

> "This canon is given reinforcement for this term because 'sale' was *not* one of the terms for which Congress provided an express or supplemental definition in § 2 ('Definitions') of the Natural Gas Act."[18]

It is one thing to declare that the FPC is not bound by Hornbook definitions or local decisions not applicable to the Natural Gas Act. But, as Commissioner Carver insisted, this is not to say the Commission is:

> ". . . at liberty to enlarge that principle into an unrestricted license to snatch our own definitions out of the cosmos, hand-tailored to fit the case, any more than problems of consideration can be swept away by denigrating reference to established legal concepts."[19]

Elsewhere petitioners sidestep the issue by question-begging phrases. Thus Mobil argues that "Commission regulation has applied to the entire *stream* of natural gas regardless of these classifications of interests under state law."[20] But Congress told the FPC to regulate "sales", not "streams". Typically the sale of *all* of the gas—8/8ths, not just 7/8ths—is made by the lessee to the pipeline. As the Court of Appeals wrote:

> "The lease terms give the lessee all possessory interests in gas produced during the life of the lease, including full right of sale."[21]

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[18]Shell pet. app. p. 9a.
[19]Shell pet., app. p. 48a.
[20]Shell pet., app. p. 10a.
[21]Mobil pet. 3-4.

That sale of the full stream *is* regulated. And the lessee-seller is likewise regulated as a "natural gas company engaged in such sale".

In considering whether the landowner has made a "sale in interstate commerce", three questions are basic and inescapable:

1. What instrument embodies the terms of sale?
2. Who is the seller?
3. Who is the buyer?

If there were a sale by a landowner, one of two instruments would embody its terms—either the oil and gas lease between the landowner and the lessee-producer or the gas sales contract between the lessee-producer and the interstate pipeline. The contrast between the two is obvious even from a cursory reading.[22] Petitioners themselves are not in agreement as to which of the instruments constitutes the alleged "landowner's sale". And the explanation in the Commission's petition is at odds with the explanation in the Commission majority's opinion which was reversed by the Court below.

The oil company petitioners advocate landowner jurisdiction by arguing that the oil and gas lease is an interstate sale—or, more accurately, that a *part* of the oil and gas lease is an interstate sale. This was the theory of the Commission majority reversed by the Court below. Chairman White argued:

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[22]A typical example of an oil and gas lease is found at R 82 and of a gas purchase contract at R 96. "R" references are to the printed appendix filed with the Court below.

> "The royalty payment provisions of oil and gas leases constitute a sale for resale of natural gas in interstate commerce subject to regulation under the Natural Gas Act and the royalty owners are natural gas companies for purposes of the Act."[23]

Recognizing, as they must, that an oil and gas lease is *not* a sale of gas under any previously accepted understanding of the term, petitioners try to carve out a part of the lease and call it a sale. Mobil, for instance, refers to "the *part* of the lessor-lessee transaction held to be jurisdictional".[24] And Amoco insists that "The only provision of the oil and gas leases . . . before the Court is" the royalty covenant.[25]

That effort to torture a lease provision into a sale by excising one clause from the entirety of the lease not only would rewrite the lease contract by the technique of massive deletion but it would also fly in the teeth of express statutory prohibitions against ignoring other parts of an allegedly regulated sale contract. Congress has imposed Commission responsibility, not merely over the rates of natural gas companies, but over:

> ". . . the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services."[26]

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[23]Shell pet., app. p. 39a.

[24]Mobil pet. 23 – italics by Mobil.

[25]Amoco pet. 6.

[26]Natural Gas Act, § 4(c), 52 Stat. 822, 15 U.S.C. § 717c(c).

If the oil company petitioners were correct in contending that an oil and gas lease constitutes a sale of gas in interstate commerce, then the signatory landowner would be required, by Section 4(c) of the Act, to file the lease with the Commission as a rate schedule. This stretch of Commission jurisdiction would call for a deluge of hundreds of thousands of oil and gas leases. In an effort to avoid that inundation, ordering Paragraph (B) of Chairman White's opinion directed that:

> "For regulatory purposes such sales are covered by the filings of the producer-operators and payment by the producers to the royalty owners should be made as provided by the contractual provisions of each lease, except that in no event should the payment exceed the just and reasonable rates as fixed by the Commission under the Act."[27]

But the producer would have filed as a rate schedule the contract made between the producer and the pipeline company and to which the landowner is not even a party.

In the oil and gas lease—if it be the instrument of sale as those petitioners urge—the producer is the *buyer*. Ordering paragraph (B) would turn Section 4(c) of the Act upside down by using the *buyer's* rate filing to cover the *seller's* sale. The fiction of that approach is underscored by the fact that the landowner may never have agreed to accept a royalty calculated on the producer's sale price—never have agreed to

[27] Shell pet., app. p. 40a.

"sell" at the producer's rate. The Commission opinion recognized that fact by requiring payments from the producer (buyer) to the landowner (seller) to be made as provided by the "contractual provisions of each *lease*" rather than by the rate schedules under which the Commission says "such sales are covered". It is a complete contradiction to say that the landowner's "sale" is covered by the producer's filing and yet to say that the rate payable to the landowner is not the rate set out in the producer's filing. It would be equally nonsensical, however, to say that a landowner, who had contracted with the producer for a royalty calculated on a fraction of the production say at five cents per MCF, would be bound to accept royalty calculated on a four cent rate established in a producer's filing for its sale to the pipeline—for the very obvious reason that the landowner never agreed with anybody on that four cent price. In fact, that price is flatly inconsistent with the only agreement that the landowner did make.

These contradictions—besides signaling the Pandora's box of problems which the jurisdictional extension would open[28]—more basically constitute a *reductio ad absurdum* of the nonsensical pretense that a part of the lease constitutes a gas sale by the landowner and he is "therefore" somehow bound by a sale contract between the lessee and the pipeline to which he was never a party.

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[28]Cf. the observation of the Court of Appeals that ". . . if the FPC's jurisdiction over royalty owners were sustained its regulatory problems might be more complicated than it has assumed." Shell pet., app. p. 20a.

The petition of the Commission, on the other hand, seems to say that the gas purchase contract between the lessee-producer and the pipeline is the instrument of sale by the landowner. To avoid the obvious answer that the landowner cannot have made a sale by that contract since he is not even a party to it, that petition suggests a new legal fiction:

> "In entering into an oil and gas lease, a royalty owner, in effect, appoints the lessee-producer as its *agent*. Under the lease, the producer is obligated to develop the leasehold and market any gas produced therefrom."[29]

From this we suppose it is intended for the Court to infer that the landowner, as principal, has sold gas to the pipeline company under a contract made for the landowner by the lessee-producer as an authorized agent. But this reasoning defies reality in a number of significant respects.

A principal has a basic right to control the actions of his agent. Yet the landowner cannot control the sale by the lessee-producer. In the same paragraph of its petition the Commission concedes that "a royalty owner has *no* control over the incidents of such a sale" and then inexplicably criticizes the Court of Appeals for giving any determinative weight to that fact.

It makes no sense at all to treat an oil and gas lease which expressly requires royalty payments on gas production to be computed on one basis as constituting an implied authorization for the lessee to

[29]FPC pet. 9.

enter into a contract with someone else that would substitute different payments to the landowner computed on another basis. How can it be rationally argued that a principal has authorized his agent to make a contract with a third party which constitutes an amendment of the agreement between the principal and the agent?

To come back to the real world—the Burnett Trustees did not choose to go into the gas production business. Theoretically they could have done so as owners of the land—though probably not without violating applicable laws on lawful investments by trustees—but the fact is they did not. Instead they leased the land to Huber. They reserved no gas. They sold no gas. Yet from the mere existence of a rejected possibility the Commission's new argument would put the Burnett Trustees in the gas business by implication:

> "If the royalty owner had not entered into the lease, but had itself developed and sold in interstate commerce the natural gas underlying its property, it would clearly be subject to the Commission's jurisdiction. The fact that the royalty owner designates another to develop and market the gas should not operate to bar Commission jurisdiction over the retained fractional interest of the royalty owner in the sale of the gas."[30]

The implications are simply contrary to fact. The Burnett Trustees did not "designate" anyone to develop and market gas for them. They leased land to Huber so Huber could develop and market gas for

[30]FPC pet. 9-10.

Huber. That a royalty is payable with respect to a fraction of Huber's production is a far cry from a principal-agency relationship. The several analogies in the Court of Appeals opinion, we believe, are proper and pertinent.[31]

Mobil, reading far more into the decision below than is there, concludes that it "disposes of questions pending in numerous fora".[32] Lessor-lessee differences are neither new nor catastrophic. They have been before many judicial forums many times.[33] The decision below undertakes to dispose of no substantive questions. It merely holds that the judiciary, not the FPC, is the place to resolve lessor-lessee controversies.

Mobil's petition p. 26 sounds another alarm:

> "The record shows that at least one state court has already concluded that the royalty owner should be paid on the basis of 'market value' even where a payment clause provides only for payment of a share of 'proceeds'."

If some state judge has committed that error, the remedy is by appeal. To suggest that an incorrect state court decision on a question of lease construction justifies a demand by the wronged party that the United States Supreme Court rewrite a federal statute to expand the authority of an administrative agency is really too much.

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[31]Shell pet., app. p. 162.

[32]Mobil pet. 21.

[33]See, e.g., *Phillips Petroleum Company v. Bynum*, 155 F.2d 196 (5th Cir. 1946); *Union Producing Co. v. Pardue*, 117 F.2d 225 (5th Cir. 1941); *Chicago Corporation v. Wall*, 156 Tex. 217, 293 S.W.2d 844 (1956); *Arkansas Natural Gas Co. v. Sartor*, 78 F.2d 924 (5th Cir. 1935), cert. den. 296 U.S. 656.

If there is to be any order in our jurisprudence, the determination of the Court of Appeals that a landowner who grants an oil and gas lease on a naked piece of ground is not a natural gas company making a sale of gas in interstate commerce must be correct. And certiorari is not needed to say so. Commissioner Carver aptly described Chairman White's reasoning to the contrary as "a bootstrap conclusion [which] taxes credulity to the breaking point."[34]

All this country needs to bring complete chaos to gas regulation is a judicial extension of FPC jurisdiction over thousands of oil and gas leases and the landowners who have rights and obligations under those leases.

The Court of Appeals properly held that Congress *intended* no such thing. Section 1 of the Act expressly refers to the reports of the Federal Trade Commission and declares that "the *business* of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest."[35] A mere landowner of an Oklahoma farm or a Texas ranch is hardly in that business. As this Court has taught, the

[34]Shell pet., app. p. 46a. The issue has received scholarly scrutiny in two separate law review commentaries on the Fifth Circuit's decision in *J. M. Huber Corp. v. Denman, supra.* Both writers reach the same conclusion. The article in 42 New York University Law Review 552, 559 (1967) analyzes the question and expresses this view as to the proper interpretation of the statute:

> "Thus Huber, in asking the FPC to regulate the royalty payable to the lessor, seeks protection for an interest not covered by the act. Whether the FPC should control the terms on which gas rights may be leased is for Congress to decide."

The editor in 45 *Texas Law Review* 765, 771 (1967) reaches the same conclusion. We commend to the Court both of those fine law reviews.

[35]52 Stat. 821, 15 U.S.C. § 717(a).

Federal Trade Commission reports—on which "the 1938 Act was based"[36]—were concerned with anything but the thousands of landowners in all the gas producing states:

> "Moreover, the investigations of the Federal Trade Commission had disclosed that the majority of the pipe-line mileage in the country used to transport natural gas, together with an increasing percentage of the natural gas supply for pipeline transportation, had been acquired by a *handful of holding companies*. State commissions, independent producers, and communities having or seeking the service were growing quite helpless against these combinations. These were the types of problems with which those participating in the hearings were preoccupied. *Congress addressed itself to those specific evils.*"[37]

Finally, Shell contends that even though the landowner makes no *sale*, the courts should impose FPC jurisdiction over the oil and gas lease on an "additional" ground. In essence the argument is that the FPC *should* have jurisdiction over gas royalties because they constitute costs which *affect* interstate sales by regulated companies. This Court is thus asked to repudiate its prior tripartite analysis[38] and add a fourth jurisdictional category.

From the premise that ". . . the price to be paid for [sic] royalty interests has a direct and substantial effect on the price paid by the ultimate consum-

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[36]*FPC v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 9 (1961).
[37]*FPC v. Hope Natural Gas Company*, 320 U.S. 591, 610 (1944).
[38]*Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*, 332 U.S. 507, 516 (1947) – quoted above at p. 6.

er,"[39] Shell would conclude that landowners are natural gas companies under the Act. But the Act says no such thing. A royalty payment to those upon whose land wells are drilled is only one of a myriad of costs which have a direct and substantial effect on the price paid by the ultimate consumer. Congress, however, directed the FPC to regulate the *sale* of gas and the *seller*—not the *costs* incurred by the seller nor the persons to whom such costs are paid.

With respect to Shell's "necessity" argument the Court of Appeals wrote:

> "If an interpretative ruling *stretching* the Act as written to cover leases by landowners is to be countenanced on the score of necessity, and we do *not* say this will be possible, the underlying record must be more comprehensive and profound—broader and deeper, as it were—than the findings and analysis presented on this record."[40]

From this foundation, petitioners argue that the Court of Appeals should have remanded for further administrative hearings. Not so. Any thought of stretching the Act because of someone's idea of necessity is more properly directed to Congress. This Court has said it well:

> ". . . the determinative question is not what the Board thinks it *should* do but what Congress has said it *can* do."[41]

The Court of Appeals for the District of Columbia

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[39]Shell pet. 8.
[40]Shell pet., app. p. 18a.
[41]*Civil Aeronautics Board v. Delta Airlines*, 367 U.S. 316, 322 (1961).

Circuit is not noted for restrictive interpretations on questions of administrative agency jurisdiction. Its conclusions in this case are eminently correct.

There Is No Conflict of Decisions

The decision of the Court of Appeals is completely consistent with prior law. As mentioned earlier, this Court has held that the Act grants jurisdiction over interstate *transportation*, interstate *sales* and *companies* engaged therein and nothing more.[42] The Court below followed that guidance.

This Court has also held that a landowner who receives royalties under an oil and gas lease is not a seller of production from the lease. In considering whether such a royalty owner makes a "sale" under a taxing statute applicable to sales, Justice Stone differentiated between royalty receipts and sale proceeds:

> "[T]he statute speaks of a 'sale' and these leases would not generally be described as a 'sale' of the mineral content of the soil, using the term *either* in its technical sense or as it is commonly understood. **Nor would the payments made by lessee to lessor generally be denominated the purchase price of the oil and gas.** By virtue of the lease, the lessee acquires the privilege of exploiting the land for the production of oil and gas for a prescribed period; he may explore, drill, and produce oil and gas if found."[43]

The decision below likewise holds that a landowner,

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[42] *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*, 332 U.S. 507, 516 (1947) – quoted at p. 6 above.

[43] *Burnet v. Harmel*, 287 U.S. 103, 107 (1932)

by receiving royalties under an oil and gas lease, does not thereby make a sale of gas. This is true, using the term in its commony understood sense—and also in its technical legal sense.[44]

The argument that the FPC has jurisdiction over payments by lessee-producers to royalty owners was rejected by the Texas courts in a 1957 action by a royalty owner against his lessee over the amount of royalty payable:

> "Respecting the FPC rates, the regulatory body simply made no effort to and did not fix a rate as between LeCuno and these litigants . . . The FPC wisely made no effort to come between the producer and its royalty owners and left the matter of costs and charges as between them to their own arrangement. . . . The regulatory authority of FPC is not involved in this suit. Nor can it be said that that agency has exclusive jurisdiction of the controversy between these litigants or even that there is *any* controversy between the litigants that the FPC in the exercise of its *lawful* authority might determine."[45]

And this Court *refused certiorari* to review that deter-

[44]Citing the Fifth Circuit opinion in *J. M. Huber Corp. v. Denman*, 367 F.2d at 113-114, the Court below noted:

> "[The lessors make] the very simple, yet profound, contention that there can be no 'sale' of gas by royalty owners since they have no gas to sell. And this seems to be true as a matter of oil and gas law, whether based on the ownership-in-place concept followed by Texas and others or on non-ownership theories of other jurisdictions. For *all agree* that as the gas leaves the well-mouth, the entire ownership of the gas is in the lessee, none being reserved in the lessor."

Shell pet., app. p. 10a.

[45]*LeCuno Oil Company v. Smith*, 306 S.W.2d 190, 193-4 (C.C.A. Tex. 1957); writ den. n.r.e. (Texas Supreme Court).

mination.[46] The decision below is also consistent with that precedent.

Petitioners, on the other hand, urge a holding which would necessarily conflict with this Court's explanation in *Mobile* of the scheme of the Natural Gas Act.

> "The basic power of the Commission . . . is simply the power to review rates and contracts made in the first instance by natural gas companies . . ."[47]

If, as petitioners contend, landowners were natural gas companies, then the royalties payable would be those established initially by agreement with the landowners. Instead the oil company petitioners would *impose* upon the landowners rates established by agreement between the oil companies and the pipeline. Mobil, for example, confesses that it would insist that royalty payments be limited to a share of the lessee's proceeds no matter what the lease said to the contrary.[48]

The Commission's petition suggests that the Commission has given a nod to the *Mobile* principle by holding "that royalty rates for interstate sales are to be governed by either the rate provided for in the lease or the just and reasonable rate as determined by the Commission, whichever is lower."[49] This would impose an area rate on landowners as a result of area proceedings to which landowners were never made

[46]Ibid., 356 U.S. 974 (1958).
[47]*United Gas Pipe Line Co. v. Mobile Gas Service Corporation*, 350 U.S. 332, 341 (1956).
[48]Mobil pet. 21-23.
[49]FPC pet. 7.

parties.[50] Then the Commission's petition, in the same paragraph, rejects the *Mobile* principle that the landowner (if it were a natural gas company) should initially make the "rate". Specifically it argues:

> "Where the just and reasonable rate has not yet been determined by the Commission, royalties are to be governed by the *producer's* effective rates, subject to adjustment upon establishment of the just and reasonable rate."

The decision below, by rejecting the pretense of a "sale" by a landowner who in reality makes no sale, remains consistent with *Mobile*.

Also the negation of FPC jurisdiction over royalties payable under oil and gas leases is consistent with the landmark *Panhandle Eastern* doctrine. Commissioner Carver put the proposition well:

> "In point of time and the legal and economic interests created, primary lease execution is clearly antecedent to any facet of 'production and gathering.' The lease constitutes the very essence of the relationship between landowner and lessee-producer. If the language in *F.P.C. v. Panhandle Eastern Pipeline Co.* (1949) 337 U.S. 498, 505, holding 'leases an essential part of production' is not controlling here, it is difficult to conceive of a case where it would be."[51]

Petitioners assert that the decision below is in conflict with three decisions of this Court in *Phillips*[52]

[50] Cf. Court of Appeals analysis, Shell pet., app. p. 20a.

[51] Shell pet., app. p. 51a.

[52] *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

Rayne,[53] *Bastian Bay*,[54] and with the "filed rate" doctrine.[55] The court below—in our view correctly—saw no such conflict.

Phillips involved only the question of FPC jurisdiction over an admitted *sale* by a lessee-producer. It has no bearing on the efforts of petitioners to extend that jurisdiction to landowners who receive royalties under oil and gas leases but who make no sale.

Rayne and *Bastian Bay* were companion cases. In fact *Bastian Bay* was summarily reversed in a per curiam memorandum decision which simply cited *Rayne*.[56] The Court below carefully analyzed these decisions and found no conflict. In *Bastian Bay* and *Rayne*, as pointed out by the Court of Appeals, this Court was confronted with "a transaction that was in *form* a lease of reserves but in economic impact the equivalent of 'conventional sales of natural gas' ".[57] Distinguishing that situation from ours the Court of Appeals accurately held:

"When we come to an ordinary lease by the

[53] *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965).

[54] *Federal Power Commission v. Pan American Petroleum Corp.*, 381 U.S. 762 (1965).

[55] *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951).

[56] Interestingly Amoco, of all people, refers to the "importance of this case to natural gas consumers and the natural gas industry" as similar to *Phillips*, *Bastian Bay*, and *Rayne* (Amoco pet. 9) and describes *Bastian Bay* and *Rayne* as examples of "parties seeking to avoid rate regulation". (Amoco pet. 14). They should know whether *Bastian Bay* and *Rayne* were avoidance cases for Amoco, under its then name of Pan American Petroleum Corporation, *was* the petitioner in *Bastian Bay*. There however, contrary to what it now says, Amoco assured the court that it was *not* using a subterfuge to avoid rate regulation.

[57] Shell pet., app. 13a.

> landowner to the producer there is neither a 'customary' sale in interstate commerce nor its equivalent in economic effect. Such a lease is a transaction that is itself customary and conventional, but one that precedes the 'conventional' sales in interstate commerce with which Congress was concerned, indeed even precedes the 'production and gathering' which § 1(b) visualized as preceding the sale in interstate commerce over which jurisdiction was being established."[58]

Amoco goes full tilt. In an effort to bring this case within those decisions, they accuse the Court below of permitting landowners "to utilize technical concepts of local law of sales to avoid rate regulation by simply *casting the transaction* in such a form"[59] as an ordinary oil and gas lease. Again they argue that the Court below permits landowners to employ concepts of local law "in *formulating* gas royalty clauses that exempt payment of royalty interests in gas sold from Commission rate regulation."[60] These charges assume, contrary to fact, that landowners have designed oil and gas leases to circumvent intended regulation under the Act. Nothing could be further from the truth. Most oil and gas lease forms have been designed by oil companies themselves—not by landowners—and in large part they antedate even the passage of the Natural Gas Act. There is nothing in the record of this case or elsewhere to suggest that these lease forms have been prepared as an escape mechanism.

Lastly Cities Services searches for a conflict with

[58]Shell pet., app. p. 14a.
[59]Amoco pet. 8.
[60]Amoco pet. 13.

the "filed rate" doctrine announced by this Court in 1951[61] and they argue that "there can be no retroactive changes of rate made effective without suspension under Section 4 of the Natural Gas Act."[62] This begs the question. The "filed rate" doctrine precludes changes, except by following the statutory procedure, in a rate previously filed with the Federal Power Commission by a natural gas company covering its sales. There is nothing in that doctrine remotely prohibiting the natural gas company from making royalty payments in compliance with its leases. If, as petitioners would have it, landowners were to be regarded as natural gas companies, then as a beginning point they would surely be entitled to receive the "rates" called for by their oil and gas leases unless and until the Commission had held a hearing finding such "rates" unlawful and prescribing new ones.[63]

Petitioners seek by administrative brute force to convert all gas lease royalty clauses into "proceeds" clauses without a hearing—with disregard to what the landowners and their lessees may have agreed to —and without filings or hearings before the Commis-

[61] *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951).

[62] Cities Service pet. 14-15.

[63] *United Gas Pipe Line Company v. Mobile Gas Service Corporation*, 350 U.S. 332 (1956). See also the holding in *Phillips Petroleum Company v. Federal Power Commission*, 258 F.2d 906, 914-5 (10th Cir., 1958):

> "It seems clear to us, therefore, that the price which Phillips was entitled to receive and Panhandle was obligated to pay, by the terms of the contract, on June 7, 1954, was the rate fixed and prescribed by the rate schedule and that such rate was *not* the price reflected by the billing statement or actually *being paid by the buyer* and received by the producer on June 7, 1954."

sion.[64] Mobil would excuse such strong-arming with the specious comment that "The 'royalty' owner bears no costs and does not engage in exploration and development."[65] This comment is consistent with the lack of a sale by the royalty owner. It is in conflict with the argument in the Commission's petition that the royalty owner has designated the lessee as an agent to explore and develop gas for him. See pp. 17-19 supra.

Besides, where would the oil companies of America be without access to the land which the landowner's oil and gas lease alone affords them? Where would this exploration and development be conducted if oil and gas leases were not available? By what process of reasoning does Mobil Oil Corporation look upon its payment of royalty to the landowner as some sort of a gratuity?

At page 26 of its petition Mobil foresees (with really no basis) massive increases in royalty payments unless the FPC immediately extends its jurisdiction to oil and gas leases and this, they imply, is contrary to the public interest. What a contrast with the position of Mobil a few short years ago before the Supreme Court of Texas.[66] In that instance Mobil itself had become the owner of some mineral interests. Gas royalties were being paid by Pan American (now

[64]**One wonders how this technique would apply to the thousands of leases to pipeline companies. In those situations the *only* sale of gas is by the pipeline company under tariffs which are many times *higher* than the field market price.**

[65]Mobil pet. 25.

[66]*Southland Royalty Company v. Pan American Petroleum Corporation*, 378 S.W.2d 50 (Tex.Sup.Ct. 1964).

Amoco) at a rate of $100 per well. Mobil thought nothing of suing to increase those payments to a royalty share of almost a million dollars worth of gas production.[67] And—most significantly—neither Mobil nor Amoco turned to the FPC in that royalty dispute although the gas was being sold by the producer in interstate commerce. Yet they now both tell this Court that the FPC has had jurisdiction over such matters for eighteen years.

The Case Involves No Matter of Serious National Concern

The controversies before this Court are private disputes between a very few major oil companies[68] and a relatively small number of individual landowners. Notwithstanding the FPC's open invitation for participation by anyone interested in the hearings below, the case has essentially been ignored by all interstate pipelines, all state regulatory agencies, virtually all distribution companies, and the vast majority of producers. That would not have been the case if significant issues of national import had been at stake.

Understandably petitioners strain to find grave consequences in their effort to provoke action by this Court. Shell speaks of national supply shortages:

> "The present crisis in the nation's supply of natural gas has received the recognition of the

[67] *Southland Royalty Co. v. Pan American Petroleum Corp.*, 354 S.W.2d 184, 190 (Tex. C.C.A. 1962).

[68] Mobil, Amoco, and Huber supported by intervenors, Shell and Cities Service.

> Courts and is receiving the continuing attention of the Federal Power Commission."[69]

The tacit implication is that the solution to gas shortages is an expanded FPC jurisdiction. Most knowledgeable parties (including Shell in other forums) feel just the opposite. To subject landowners to regulation of a federal administrative agency simply because lessees of their lands produce and sell gas in interstate commerce would hardly be calculated to increase the available leaseholds without which drilling and production are impossible. Common sense compels the conclusion that many landowners would refuse to lease their lands or lease it upon condition that gas sales be made only in intrastate commerce.

Mobil utilizes the technique of large numbers by alluding to the fact that royalty is paid with respect to "13,000,000 million cubic feet sold each year" subject to FPC regulation.[70] The point is that *all* of that "13,000,000 million cubic feet" is already subject to FPC control as it is sold by the producer in interstate commerce. Only four or five major oil companies think regulation must be expanded behind the sale and over the seller's royalty costs in order to remain effective.

With mounting momentum Mobil resorts to coercive threats to have all the area rate proceedings nullified unless this Court agrees to their petitions for certiorari:

> "A more immediate result will be that if the opinion below should become final, petitioners

[69]Shell pet. 11.
[70]Mobil pet. 16.

> must seek immediate remand to the Commission of four 'area rate' cases now on review and by which the Commission had fixed rates for more than 60 per cent of the natural gas moving in interstate commerce."[71]

We question whether Mobil really would seek any such remand but, in any event, Mobil seeks many things which Mobil does not get. Amoco raises similar specters:

> "Even so, the administrative burden of processing rate schedule filings by royalty interest owners that may be required would be insignificant, when compared to the burden of (1) reopening past and pending area rate proceedings, (2) revising the area rate method of regulation, and (3) intervening in state court suits brought by royalty owners which would be required if the opinion of the Court below is allowed to stand."[72]

Not even Chairman White, in writing his opinion in support of jurisdiction, saw any consequences even remotely resembling those described by Mobil and Amoco.

The Commission's petition says, "unless overturned, the decision will significantly inhibit the Commission from effectively regulating the rates at which such gas is sold."[73] There is no justification for that fear. And if the FPC really needs expanded jurisdiction to do its job, Congress is the proper body to grant such enlargement. Actually the Commission has regulated

[71]Mobil pet. 20.
[72]Amoco pet. 16.
[73]FPC pet. 8.

pipeline rates since 1938 and producer rates since 1954 without experiencing the slightest difficulty from lack of jurisdiction over landowner royalties.

We suspect that this is not the first time this Court has seen consequences of decisions below grossly exaggerated. And we doubt that anything we could say further would make those exaggerations more evident than they already are.

CONCLUSION

The Court of Appeals issued a tightly reasoned, highly professional opinion. It properly disposes of a rather clear cut legal issue. Certiorari to reconsider that issue in the highest court of the land is unnecessary and should be denied.

Respectfully submitted,

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May 12, 1972.

JUN 30 1972

No. 71-1169

IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

MOBIL OIL CORPORATION,
Petitioner,
v.
CARL F. MATZEN, *et al.*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

PETITION FOR REHEARING

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June 30, 1972

WILSON - EPES PRINTING CO., INC. - RE 7-6002 - WASHINGTON, D. C. 20001

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PETITION FOR REHEARING

Mobil Oil Corporation, petitioner herein, respectfully petitions this Court for rehearing upon the order entered on June 7, 1972,[1] denying the petition for writ of certiorari and moves this Court for an order (1) vacating the order of June 7, 1972, and (2) granting the petition.

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[1] Mr. Justice Douglas was of the opinion that certiorari should be granted; Mr. Justice Stewart and Mr. Justice Powell took no part in the consideration or decision of the petition. The same order was entered in companion cases: Amoco Production Co. v. Waechter, *et al.*, No. 71-1179; Cities Service Oil Co. v. Matzen, *et al.*, No. 71-1188; Shell Oil Co. v. Matzen, *et al.*, No. 71-1191; and Federal Power Commission v. Mobil Oil Corporation, *et al.*, No. 71-1326.

1. The Decision In *Federal Power Commission* v. *Louisiana Power & Light Co., et al.*, Nos. 71-1016, *et al.*

On June 7, 1972, this Court entered its decision in *Federal Power Commission* v. *Louisiana Power & Light Co.*, —— U.S. —— (Nos. 71-1016, *et al.*, Oct. Term 1971).

The Court there decided issues of Federal Power Commission jurisdiction under the Natural Gas Act over allegedly "non-jurisdictional" activity; affirmed the Commission's assertion of jurisdiction; and noted, with apparent approval, steps by the Commission to cope with a shortage of natural gas.

That decision underscored the reasons the petition should be granted in the instant case; highlights the divergence between this Court's analysis and decisional process in interpreting the Natural Gas Act and the erroneous analysis and interpretation by the Court of Appeals in the instant case; and takes note of compelling reasons, equally applicable in the instant case, for reversing a Court of Appeals opinion which had construed Commission authority far too narrowly and had failed to accord weight to Commission objectives in its exercise of jurisdiction in the face of a national shortage of natural gas.

In the *LP&L* case, the principal question was whether the Commission had jurisdiction to regulate curtailment of direct sales of natural gas. In the instant case, the principal question is whether the Commission has jurisdiction over the rate for the "royalty" interest in jurisdictional sales of natural gas for resale. In *LP&L*, an opinion by the Court of Appeals for the Fifth Circuit departing from principles controlling construction of the Natural Gas Act was reversed; but in the instant case, an equally erroneous opinion by the Court of Appeals for the District of Columbia Circuit would be left standing. This Court's opinion in *LP&L* is a step-by-step index to the errors below:

(1) This Court first noted reports of the national shortage of natural gas, the remaining committed re-

serves of 259.6 trillion cubic feet, and Commission efforts to conserve that supply (*LP&L*, slip op., pp.4-5 and n.2); but in the instant case, the court below would permit between 12.5% and 25% of that volume to pass out of Commission rate control and out of the framework of the area rate structures now designed to cope with the very same emergent shortage recognized as the genesis of the orders reviewed in *LP&L;*

(2) This Court reiterated that "FPC regulation was to be broadly complementary to that reserved to the States, so that there would be no 'gaps' for private interests to subvert the public welfare" (*LP&L*, slip op., p. 9); but in the instant case, the court below has overturned a Commission effort to close exactly that type of gap in control of rates for 12.5% to 25% of the total volume now sold in interstate commerce in fields of production;

(3) This Court relied upon the controlling principle that ". . . in a borderline case where congressional authority is not explicit we must ask whether state authority can practicably regulate a given area and, if we find that it cannot, then we are impelled to decide that federal authority governs" (*LP&L*, slip op., p. 10); but in the instant case, this principle was not followed below;

(4) This Court in *LP&L* made express detailed inquiry into whether there was a "gap" and whether state regulatory authority could reach the acts in question (*LP&L*, slip op., pp. 11-12); but in the instant case, this required test in reviewing the Natural Gas Act was disregarded below, *even though this Court already has held that the very rates, sales, and volumes in question are not within permissible state control, but could be reached only by federal authority;*[2]

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[2] Compare the *LP&L* decision, the opinion below in the instant case, and *Northern Natural Gas Co.* v. *State Corp. Commission of Kansas*, 372 U.S. 82 (1963), and *State Corp. Commission of Kansas* v. *Cities Service Gas Co.*, 361 U.S. 836 (1959).

(5) This Court in *LP&L* again cautioned that there must be an "inquiry into the necessary consequences" of a contention that the FPC is without jurisdiction, and canvassed the disruption of interstate commerce and federally-protected interests that could flow from "contradictory regulation" (*LP&L*, slip op., pp. 10-14); but in the instant case, the Commission's findings and conclusions as to such disruptive effects were brushed aside and given no weight;

(6) This Court in *LP&L* meticulously reviewed the legislative history of the Natural Gas Act and particularly the indicia of Congressional intent that no "gaps" were intended and that practical, effective Commission control was intended despite state classifications (*LP&L*, slip op., pp. 14-20); but in the instant case, the Natural Gas Act was construed *without a single reference in the opinion to the legislative history of the statute;*

(7) This Court in *LP&L* gave attention to the position of consumer interests and consumer states as pertinent to questions of intended reach of the Natural Gas Act and of necessity for FPC action (*LP&L*, slip op., pp. 12-14); but in the instant case, the court below brushed aside expressions on behalf of such interests and failed to note that the position on jurisdiction asserted there (and now here) by Mobil and by the Commission was supported by all parties representing the interests of consuming states and ultimate consumers of natural gas.[3]

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[3] Before the Commission, Mobil's position as to necessity for the Commission's *continued* exercise of jurisdiction over the rates for the royalty interests thus was supported by the Commission's Staff, The People of the State of California and The Public Utilities Commission of the State of California, and the "Eastern Distributor Intervenor Group" consisting of Brooklyn Union Gas Company, Consolidated Edison Company of New York, Inc., Long Island Lighting Company, Orange and Rockland Utilities, Inc., Philadelphia Electric Company, Philadelphia Gas Works, Division of The United Gas Improvement Company, and Public Service Electric and Gas Company (see Mobil Appendix, pp. 87-88; 48, 52).

(8) This Court in *LP&L* reached a conclusion consistent with the touchstone for interpreting Congressional intent as to proper Commission reach under the Natural Gas Act (slip op., p. 19):

> "Therefore, when we are presented with an attempt by the federal authority to control a problem that is not, by its very nature, one with which state regulatory commissions can be expected to deal, the conclusion is irresistible the Congress desired regulation by federal authority rather than non-regulation. *Federal Power Commission* v. *Transcontinental Gas Corp.*, 365 U.S. 1, 18 (1962)."

In the instant case, all of these steps and controlling criteria for construction of the Natural Gas Act were applicable. Yet, they have not been observed. Therefore, all of the reasons this Court found in *LP&L* for a reversal of the Court of Appeals and for affirmation of Commission jurisdiction are reasons the petition in the instant case should be granted. In *LP&L*, this Court also quoted its recognition that in natural gas producer rate regulation, " 'the width of administrative authority must be measured in part by the purposes for which it was conferred . . . Surely the Commission's broad responsibilities therefore demand a generous construction of its statutory authority.' *Permian Basin Area Rate Cases*, 390 U.S. 747, 776 (1968); see *United Gas Pipe Line Co.* v. *Federal Power Commission*, 385 U.S. 83, 89-90 (1966)." (*LP&L*, slip op., p. 21).

In contrast to those views of this Court, the opinion below in the instant case would stand as an aberration opening a "gap" Congress clearly meant to close. In contrast to the views expressed below, this Court also recently reiterated (1) that such concepts as "title" under "ordinary" property law are *not* controlling in application of federal law;[4] (2) that a federal regulatory agency's

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[4] Compare *Fuente, et al.* v. *Shevin*, —— U.S. —— (Nos. 70-5039, *et al.*, June 12, 1972) and the opinion below (Mobil App., p. 24).

assertion of authority may be sustained where clearly and "reasonably ancillary" to effective performance of the agency's regulatory responsibilities;[5] and (3) that in review of agency action, "necessity" for action and agency objectives, particularly in the face of a shortage of a given service, must be given great weight.[6]

Only review by this Court now can make possible the application of these principles and those applied in *LP&L* to the important questions of construction of the Natural Gas Act at issue in this case, which affect all sales in interstate commerce of natural gas for resale.

2. Disruption of Commission Area Rate Regulation In The Face of A Shortage of Natural Gas

In the petition in the companion case No. 71-1326, the Solicitor General, on behalf of the Commission, advised this Court that unless ". . . overturned, the decision below will significantly inhibit the Commission from effectively regulating the rates at which such gas is sold." (Pet., No. 71-1326, p. 8).

The Solicitor General also called attention to the parallel between the instant case and the jurisdiction issues in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954);[7] and correctly stated:

> "If royalty owners are now entitled to royalties based on the 'market value' of natural gas as in-

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[5] *United States* v. *Midwest Video Corporation*, —— U.S. —— (No. 71-506, June 7, 1972), citing *United States* v. *Southwestern Cable Co.*, 392 U.S. 157 (1968).

[6] *United States* v. *Allegheny-Ludlum Steel Co.*, —— U.S. —— (No. 71-227, June 7, 1972).

[7] Significantly, this Court denied the petitions for writs of certiorari in *Phillips*, but upon petitions for rehearing, granted rehearing and granted the petitions (see 346 U.S. 896 and 347 U.S. 672); and ultimately affirmed on the merits as to existence of Commission jurisdiction.

terpreted by state or federal courts or state regulatory authorities, the owners would in many instances receive compensation in excess of the royalty component allowed in the area rates determined by the Commission. The Commission would then be required either to let producers absorb the increased royalty obligations or to adjust area rates upward to accommodate the higher payments, thereby causing consumers to pay higher prices for natural gas. In short, the Commission's control over one significant component in the establishment of area rates would be lost." (Pet., No. 71-1326, p. 12, fn. omitted).

Significantly, if this Court's order of June 7, 1972 stands, the process of so unraveling all of the Commission's existing area rate decisions must begin and continue in the Courts of Appeals during the remaining months of 1972. All such FPC decisions rest on the now reversed exercise of Commission jurisdiction over the royalty rate, and all of these decisions would have to be remanded and reconsidered as to more than 60% of the gas now moving in interstate commerce:

(1) On June 12, 1972, briefs were filed necessarily seeking such a remand in Texas Gulf Coast Area Rate Cases (PSC of NY v. FPC), Nos. 71-1828, *et al.*, D.C. Cir.;

(2) Before oral argument in October, 1972, such a remand must be sought in Southern Louisiana Area Rate Case (Placid Oil Co. v. FPC) No. 71-2761, Fifth Circuit, in which the last briefs were filed in May, 1972;

(3) Briefs now under preparation must seek such a remand in Other Southwest Area Rate Case (Shell Oil Co. v. FPC), Nos. 72-1114, *et al.*, Fifth Circuit; and

(4) Appropriate pleadings also must be filed in Hugoton-Anadarko Area Rate Case (People of the State of California v. FPC), No. 71-1036, Ninth Circuit, in which oral argument was had on May 11, 1972.

None of these disruptions need occur, if, as the Commission advises, the clearly erroneous opinion below were reversed.

In *LP&L*, this Court so noted and stopped a severe disruption of Commission efforts to cope with the natural gas shortage at the "service" ends of pipelines, but in this instance, a more far-reaching disruption of the Commission's program would occur at the "supply" end of the pipelines in all fields of production. Commission and industry efforts to conserve, dedicate, and commit funds to increasing exploration and development for supplies to meet increasing, unmet demand would be undermined by diversion of funds to pay soaring "market values" on royalty interests in existing sales, as announced by myriad courts. Neither consumer, producer, pipeline, nor distributor interests in adequate service, adequate supply, and reasonable rates can be advanced by such results.

The practical effects of a reversal of the Commission, so carefully assessed in *LP&L*, therefore should be considered by this Court in the instant case and fully warrant the granting of the petition. Clearly, the process indicated in *LP&L* for review of Commission objectives and impact of reversal was not followed below in this case.

CONCLUSION

For the foregoing reasons, as well as those set forth in the petition for writ of certiorari, petitioner prays that this Court grant rehearing of the order of denial, vacate that order, grant the petition, and review the judgment and opinion below.

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June 30, 1972

CERTIFICATE OF COUNSEL

As counsel for the petitioner, I hereby certify that this petition for rehearing is presented in good faith and not for delay and is restricted to the grounds specified in Rule 58(2).

/s/ _____

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